RAILROADS

CASES AND SELECTIONS

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PREFACE

This book has been prepared by the editors to accompany their respective volumes on railroad transportation: Jones, *Principles of Railway Transportation*, and Vanderblue and Burgess, *Railroads: Rates—Service—Management;* and frequent cross references to these books appear in the footnotes. It is believed, however, that the selections are of such a nature that they can be used to advantage in connection with other college texts, or even independently as the bases of class discussion where lectures are used to present the general argument of the course. With these various possibilities in mind, the book has been divided into seven parts, as follows: Part I—Development of the Railroad Net; Part II—Rates; Part III—Service; Part IV—Finance; Part V—Combination; Part VI—Labor; Part VII—Conflict of State and Nation.

The greater portion of the volume consists of decisions of the Interstate Commerce Commission, the Railroad Labor Board, and the Supreme Court of the United States. Significant historical and critical discussions are also included where the case material seems to require supplementing, or where, from the nature of the subject-matter discussed, no satisfactory case material exists. But the book is primarily a collection of cases which aims, by providing a carefully selected body of supplementary material, to give concreteness to the principles developed in the more general works on railroad transportation, and to stimulate the student in his thinking. Experience with a portion of these materials, when published in preliminary form for the use of the class in Railroad Transportation at Northwestern University, demonstrated their usefulness in this regard.

The editors wish to express their gratitude to the various authors and publishers who have so generously granted permission for the reproduction of copyrighted material. The Interstate Commerce Commission has extended many courtesies, and Mr. William J. Koebel of the Commission's staff has been especially helpful. For the reading of the proofs we are indebted to Miss E. F. Philbrook of Cambridge.

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PART I

DEVELOPMENT OF THE RAILROAD NET

RAILROADS: CASES AND SELECTIONS

CHAPTER I

THE ECONOMIC BASIS OF TRANSPORTATION DEVELOPMENT[1]

A hundred years ago the only railroad known was the tramway. Twenty-five years later the steam locomotive existed as an object of speculative interest, but it had no place in the world's industrial system. The second quarter of the century was given over to experiments, and to the development of practical ideas of construction and management; yet during this brief experimental period about eighteen thousand miles of railroad were built, and over $1,500,000,000 of capital expended. More than nine thousand miles of this development took place within the United States,—a new country, with little capital available. It is at first a matter of surprise that such large capital should have been devoted to a new undertaking, and more especially that a large proportion of the expenditure should have been in a country slightly developed and little known. Some writers have regarded it as a period given over to reckless adventure, which is said to have brought with it wholesale destruction of capital and national disaster. But we must not forget that this was also a time of great material progress, and that few of these early railroads were unsuccessful from the point of view of national wealth. In England such enterprises as the Liverpool and Manchester, the London and Southampton were got under way. In America the Western, the Boston and Providence, the Old Colony, and the Boston and Lowell of Massachusetts; the Hartford and New Haven of Connecticut; the Philadelphia and Columbia and the Philadelphia and Trenton of Pennsylvania; the Camden and Amboy of New Jersey; the Baltimore and Ohio and the Baltimore and Susquehanna

[1] From F. A. Cleveland and F. W. Powell, *Railroad Promotion and Capitalization in the United States*, chapter V (1909). Reproduced by permission of the authors and Messrs. Longmans, Green, and Company.

of Maryland were a few among the many successful projects launched before 1850. Taking the entire list of roads built during this early period, it would be difficult to find even a local tramline which has not become a permanent part of some splendid system of transportation. In England, Germany, France, Belgium, and in the United States these early railroads were, and are to-day, among the most valuable and productive properties in the whole economic system. Furthermore, not a few of these early roads were regarded as conservative investments, and subsequent experience has approved the judgment of the men of that day who had sufficient capital fully to equip the enterprises. Within a century it is probable that the people of the United States had invested no less than twelve billion dollars in the improvement of country roads and turnpikes, one billion dollars in river and harbor and canal improvements, state and national, and twelve billion dollars in the construction and equipment of tramlines and railroads,—not less than twenty-five billion dollars of capital found employment in inland transportation enterprise.

The principle underlying investment is a judgment of certainty of return. To attract the investor to old and well established enterprise, there must be *assurance of income* on capital expenditure. To attract the investor to new and untried fields, there must be an *assurance of increased profits*,—something above the current rate. Something in the nature of a "bonus" must be held out to cause thoughtful men to turn away from old and well-known lines of investment. What was there to give this assurance? What was the situation which offered profits in transportation development?

A vast wilderness with only a fringe of civilization, a continent almost unexplored, was the America of 1790. The frontiersman was still to be found in the small clearings of Maine, New Hampshire, and Vermont. Fully two-thirds of New York and Pennsylvania was yet unclaimed,—a common hunting ground. In this situation was found the extraordinary inducement, the "bonus" held out to investors in any schemes of transportation which would make the inland resources available. Here were whole empires of valuable timber and agricultural lands, rich deposits of iron, coal, and other minerals—all materials of national wealth—waiting, a prize to him who might claim them as a reward for enterprise. The cost of transportation

equipment has been enormous, yet the inducement has been at all times sufficient to attract the investor.

The financial inducement to transportation improvement was of two kinds: the saving which it would make within the territory already developed; and the interior resources which might be reclaimed beyond the reach of the system supplanted. By way of illustration of the relative advantages of the various kinds of road equipment, let us take a town as a centre. Assuming all the land round about equally adapted to yielding a crop of oats, which might be marketed at ten dollars an acre on delivery at this trade centre: Over an ordinary horse path or trail a horse may carry about two hundred pounds; on a cart, over a good dirt road, the same horse may draw one thousand pounds; on a turnpike of macadam bed, about two thousand pounds. From this statement of the case, the relative advantage to the producer of the better road is apparent. If a pack horse could move the product of two acres a mile a day, at a cost of two dollars, then the net return would be nine dollars from each acre one mile from the trade centre, eight dollars from each acre two miles distant, etc., until the ten-mile limit had been reached, when the cost of transportation would consume the entire selling price of the product, and render production an economic impossibility. In fact, cultivation would stop before this point was reached, owing to the cost of making the crop. Under exactly the same conditions of production above assumed, it would cost only one-fifth as much to get to market in a cart over a dirt road. The result would be that over one million dollars annually would be saved to this small community in decreased cost of transportation within a radius of ten miles. The capital cost of the necessary equipment would not be more than six hundred thousand dollars. Assuming that the land were all improved and awaiting better roads, about one hundred and seventy per cent would be the annual return to the community on the investment. Besides this saving the area of production would be carried from twenty to forty miles farther into the interior. From twenty to forty miles of tributary territory with all its productive resources would be reclaimed, and the income over cost of production within the marginal circle would be an additional gain. But under our assumption, oats being the only crop, when the fifty miles limit had been reached by the dirt road, then all the territory outside this limit would be without a market. With each

kind of crop, the same principle would apply, limits of practical activity being determined by cost of production and market price. The advantage to be gained through better transportation facilities not only explains the early appropriations, but the early acts also show that the inducement was clearly perceived; this fact being set forth in the preambles of many of the laws appropriating money for local improvements.

Convert the common wagon road into a macadamized road and the cost of transportation would again be reduced about one-half. On the assumption above, over sixteen million dollars per annum would be saved to the community within a radius of fifty miles, at an added capital cost of about sixty-four million dollars; that is, some twenty-five per cent could be realized by the community on the investment within the area previously equipped with wagon roads, while the radius of profitable production would again be extended. All lands within from sixty to eighty miles would be brought within the range of the central market. True, no such uniformly fertile and uniformly developed community exists, and as a result turnpikes were built only as trunk lines through the best producing land and on the most travelled routes. But the principle is the same, and the argument quite as potent. With this computation in mind, it is easy to understand why the stock in some instances was subscribed four times over by those interested in obtaining better roads.

Around Philadelphia were ordinary mud roads, which were impassable during a large portion of the year. The western terminus of the Lancaster pike was to be in the Susquehanna valley, and a large and fertile territory would thus be opened to trade in this city. The business of merchants would be increased, the resources of the country would be more fully developed, and industry would become more active. It mattered not whether the profits of the enterprise were to be shared by the subscribers as dividends to stockholders, or were to come in the form of increased business prosperity; the inducement for capitalization was present, and the plan of profit sharing was important only in determining the class of interests to which appeal was to be made for the capital necessary for the improvement. Certain it was that the enterprise would be a fruitful investment to the community at large. If the subscriber were an investor (a capitalist), he would look to dividends; he would base his judgment upon a rate of toll which would bring to the corporation

the largest income. If he were a merchant, a manufacturer, a farmer, or a legislator representing the various interests of the state, his prime motive might be that of lowering rates of toll as a means of extending trade or industry and increasing the net profits of business. An effort was usually made to draft the plan and limit the tolls in such manner as to appeal to both classes. That this mental calculation was ever present in the minds of the people, as well as a guiding principle in legislative action, appears not only from the contemporary press, but also from the assembly records themselves. The ever present question was, what is the lowest maximum rate of toll which will leave a margin sufficient to attract capital to the enterprise? In some instances, the toll was fixed at a definite maximum per mile; in others, greater latitude was left to the company for the exercise of discretion by the introduction of a clause limiting profits to a maximum rated to capitalization. Still other charters contained both regulatory provisions. Thus the charter of the Eastern and Wilkesbarre turnpike road company in 1803 prescribed the tolls, and limited the dividends to six per cent on the stock. The Uniontown and Cumberland charter in 1804 prescribed the tolls, and limited the dividends to nine per cent on the stock. The apportionment of profits was a compromise in which a very large percentage of the gain was distributed to the general community in the form of lower rates, a certain maximum rate of toll being given to the company as a source of dividend.

A hundred miles of good road on the seacoast was but a narrow fringe when compared with the network of traffic lines necessary to serve a great stretch of inland territory which could not be economically reached by a road wagon. Under ordinary conditions, wheat at a dollar a bushel cannot be hauled with profit more than one hundred and fifty miles; while lumber, charcoal, mineral coal, iron ore, hay, and grain will permit of transportation a much less distance. The only solution for the transportation problem for a large portion of the interior was therefore to be found in further improvement, better equipment, and lower cost. In England the canal had already proved a success to the producer in lowered rates; and to the investor in handsome returns in the form of dividends. By means of a canal a single horse could draw from ninety thousand to one hundred and twenty thousand pounds as easily as two thousand pounds could be hauled by wagon on a turnpike. With this equipment one horse

and one drayman could haul as much as fifty horses with fifty carts and fifty draymen. In the most favorable localities the capital cost of a canal was from three to five times greater than the capital cost of a turnpike. Where the lay of the land was less favorable to canal construction, the capital cost increased in proportion to the difficulties of excavation and the expense of locks to obtain water level.

This large capital cost confined the advantages of canal transportation to a long haul. Within a narrow radius the saving would be small; in the well settled and well improved districts, the average gross return from an acre of agricultural land did not exceed ten dollars. Assuming that on a turnpike it would cost one dollar to market the produce of an acre of land ten miles distant, the saving within this small radius would not pay the interest on the increased capital cost of a canal. At twenty miles, however, under exactly similar conditions, it would cost three dollars per acre; at fifty miles the cost of carriage over a turnpike would be five dollars per acre. The advantage to the producer from a cheaper means of transportation would increase directly with the distance, and at fifty miles the inducement to canal construction would be five times as great as at ten miles. From fifty to one hundred miles back from the coast, or from navigable waters, every interest would favor canal construction wherever there were sufficient resources to warrant the expenditure.

Immediately after the Revolution several canals were projected, and as already shown, Washington was active in the promotion of the Potomac company. But the country was not sufficiently developed to furnish a base for long haul operations. With the beneficial results following the construction of the first canals there arose a demand for a means of reaching interior points which were beyond the range of water transportation. For a large portion of the country some improved form of land transportation was imperative, and the great question before the people was by what means this could be obtained. The success of the railroad in England furnished the answer to this question.

We may not say, therefore, that investment in the early railroads in this country was a venture in the dark. The results of experiments in England were carefully considered, and much attention was given to the study and exposition of the economic advantages to result from the introduction of the railroad in

particular localities. That this is true may be shown by this sentence from a message of Governor Lincoln of Massachusetts, in which he considered the proposed Boston and Providence railroad: "From satisfactory estimates, and calculations upon the present travel and occasion of transportation, the net receipts from use of the road, after deducting all charges for keeping it in repair, carriages, &c. and upon a saving of one-half in the present cost of transportation, will amount to a sum exceeding sixty thousand dollars per annum." The natural conclusion, therefore, was "that the construction of the road would be of great public advantage, and a profitable investment of capital."

This estimate was made for a region well settled, and one in which there was already a good turnpike road which travellers reported the best in America. The entire length of the proposed road was to be only about thirty miles, and yet the investment value was considered to be such as to earn about forty per cent on the cost each year. A portion of this was to go to the general community in the form of lower rates; the remainder was to go to those furnishing the capital as return for investment. Estimates of similar nature might be multiplied.

Effort to secure a fair division of the profit which might accrue from improved methods of transportation between the producing public and those who might contribute the funds necessary to the undertaking found expression in nearly all of the early charters. In this the legislatures followed the practice established with respect to turnpikes. Commercial rivalry between important trade centres was directly appealed to; and not only was local pride and community interest urged as a reason for support, but the investor was also interested through promises of dividends to be realized on the capital necessary to construct a more convenient means of transporting goods and passengers from the distant interior.

The manner in which the interior interests regarded improvement of this kind is illustrated by a letter from a member of congress to Niles' Register: "I have just received letters from two of ten or fifteen merchants at Wheeling, who state that they alone have forwarded by wagons to Baltimore, on the Cumberland road, during the last year, 3,000,500 lbs. of country produce, tobacco, &c. equal to about 1,750 tons; loading perhaps, 900 or 1,000 wagons; and one of the gentlemen expresses the confident opinion that if the cost of transportation were reduced 1/3 or 1/2,

there would be forwarded from that place alone and the neighborhood (independent of all produce of the rich and productive intermediate country), at least 200,000,000 lbs. or 100,000 tons of produce annually. Such has been the effect of the *Cumberland road*, and such would be the effect of a *rail road* from *Baltimore to the Ohio, at Wheeling or Pittsburg*."

The introduction of the steam locomotive gave to the railroad its advantage over the canal. Time in transportation is one of the chief elements of cost. A saving of time is a saving of expense. The railroad allows of the transportation of many products which otherwise might not be marketed at all,—products which deteriorate rapidly with age. By the introduction of the canal and the railroad the margin of profitable industry was extended a thousand or fifteen hundred miles inland. The saving of time made by the adoption of steam locomotion brought the resources of the continent in touch with the common market place.

As late as 1817 it was stated in a report to the New York legislature that the cost of transporting a ton of freight from Buffalo to New York was one hundred dollars, or twice the value of wheat at Buffalo and four times the value of corn. The advantage to be capitalized in providing some cheaper mode of transportation from the Great Lakes to the Hudson was therefore apparent. With the building of canals, transportation costs were greatly reduced, but their construction absorbed so much capital that they could be employed to advantage only upon long distance business. Within any short radius, productive possibilities were so limited that the saving from the introduction of artificial waterways was too small to warrant their construction. The introduction of canals, therefore, necessarily resulted in greatly enlarging the territory tributary to the marketing centres which they were built to serve, but they could not effectively serve that great interior from which the products of American industry were to come. This was to be reached by some mechanical means which could serve each of the small areas of the continent. The character of appeal made to the community for the support of railroad projects, and the economic basis for its capitalization, is illustrated by the following:

TABLE SHOWING THE VALUE PER TON OF WHEAT AND CORN AT DIFFERENT DISTANCES FROM MARKET—UPON A RAILROAD; AND UPON A COMMON ROAD

MILES	RAILROAD		ORDINARY ROAD	
	Wheat	*Corn*	*Wheat*	*Corn*
0 (At Market)...	49 50	24.75	49.50	24.75
10..................	49.25	24.60	48.00	23.25
20..................	49.20	24.45	45.50	21.75
30..................	49.05	24.30	45.00	20.25
40..................	49.00	24.15	43.50	18.75
50..................	48.75	24.00	42.00	17.25
100..................	48.00	23.25	34.50	9.75
150..................	47.25	22.50	27.00	2.25
160..................	47.10	22.35	25.50	.75
170..................	46.95	22.20	24.00	
200..................	46.50	21.75	19.50	
250..................	45.75	21.00	12.00	
300..................	45.00	20.25	4.50	
320..................	44.70	19.95	1.50	
330..................	44.55	19.80		

Thus a ton of corn one hundred and seventy miles from market was not worth hauling over a common road, but its value when rail carriage was possible was $22.20. And a ton of wheat while not worth the cost of a wagon haul of three hundred and thirty miles, by the very fact of the existence of a connecting line of railroad was worth $44.55. Admitting that it must have been based upon a rough approximation, such a showing as this contributes toward a better understanding of the spirit which animated those who supported the early railroad ventures. Although many problems remained to be worked out, and the future could not be clearly seen, the one fact that the railroad presented itself as so tremendously effective an instrument of trade compelled its adoption. "It is not merely because his supreme happiness consists in that speed which annihilates time and space," wrote Chevalier in 1835, "it is also because he perceives, for the American always reasons, that this mode of communication is admirably adapted to the vast extent of his country, to its great maritime plain, and to the level surface of the Mississippi valley, and because he sees all around him in the native forest, abundance of materials for executing these works at a cheap rate. This is the reason why railroads are multiplied in such profusion, competing not only with each other, but entering into a rivalry with rivers and canals." [1]

[1] Chevalier, *Society, Manners and Politics in the United States*, p. 337.

CHAPTER II

THE GEOGRAPHICAL DISTRIBUTION OF RAILROADS[1]

The internal commerce of any country is based upon geographical conditions of size, location, zonal extent, and various topographical features tending to modify soil and climate. The larger a country, the greater in general are its chances of a diversified surface, contrast of climate, and hence the multiplicity of products which leads to exchanges. Large extent means wide climatic variation such as that between New England and Florida, Minnesota and Louisiana. . . .

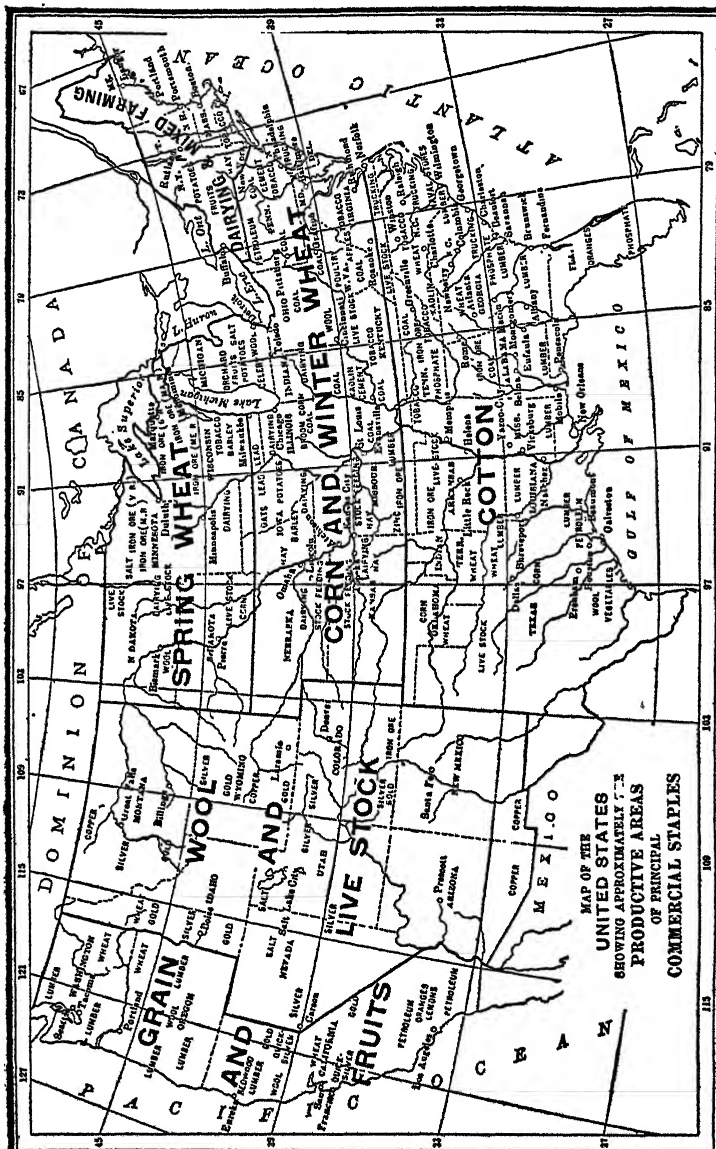
No other continuous political area in the world, with the possible exception of China, shows so many different geographical divisions distinguished by different staple products as the United States. The accompanying cartogram makes six such divisions. We would add an Appalachian section of coal, iron, and lumber, and insert a purely live-stock section in the arid belt of the Great Plains, between the ninety-ninth meridian and the Rocky Mountains, which should be distinguished from the Cordilleran area of live-stock and mining products. These two with the Pacific coast section are divided approximately by meridional lines.

[1] From Ellen Churchill Semple, *American History and its Geographic Conditions*, chapter XVII (1903). Reproduced by permission of the Houghton Mifflin Company. Other chapters of this volume trace the development of transportation routes before the days of the railroad, and provide the geographic and historical setting for the material here reproduced.

Since Miss Semple's volume was published there has been some important railroad construction, notably in the Far West: the completion of the Los Angeles and Salt Lake line of the Union Pacific, to which she refers on p. 30; the construction of the Western Pacific; the extension of the Chicago, Milwaukee and St. Paul to the Puget Sound country; the linking-up of the Chicago, Rock Island and Pacific with the Southern Pacific via El Paso; and the building of the San Diego and Arizona, the latter carrying the Southern Pacific to its "natural terminus." (p. 31). The Wabash-Pittsburgh Terminal (later the Pittsburgh and West Virginia) has been built and reorganized; and there have been important extensions in the Southwest: notably the cross-Texas line of the Atchison, Topeka and Santa Fé; the present New Orleans, Texas and Mexico which was originally a St. Louis and San Francisco project; the Trinity and Brazos Valley; and numerous branches and extensions of the Rock Island, including the connection with the newly built El Paso Southwestern, which latter road has recently been acquired by the Southern Pacific. The Atlanta, Birmingham and Atlantic; the Carolina, Clinchfield and Ohio, and the Key West extension of the Florida East Coast were the projects of largest importance carried through in the South.—Ed.

The Great Plains section marks an area of aridity due to remoteness from the Atlantic and Gulf winds. The Cordilleran is also an area of scant rainfall due to the enclosing mountains, but is also a mining region in consequence of the outcropping of valuable strata in this area of upheaval. In the Pacific coast division, proximity to the ocean and exposure to its mild western winds have also created another climatic section running across the axis of the zones. East of the ninety-ninth meridian, on the other hand, latitude exerts its full influence in drawing the dividing lines between the spring wheat, corn, and cotton sections. Only the uplifted belt of the Appalachians cuts across the grain of the parallels. The division formed by New York and New England is further distinguished as the area of excessive glaciation. This section, together with New Jersey and Pennsylvania, has reached most intensive industrial development, and is therefore dependent upon the rest of the country for subsistence and raw materials.

With this specialization of products, no section is self-sufficing and each depends upon all the rest. The stock of the Rocky Mountain states moves now to the packing-houses on the Missouri and Lake Michigan which are feeding New York, Boston, Halifax, and London; now to those on the Pacific coast which are furnishing meat for the growing Hawaiian, Alaskan, and Asiatic trade. The Columbia and Puget Sound regions send their lumber, canned fish, and wool to supply the East and get in exchange the finished merchandise which goes to swell the current of commerce. Cotton moves from the Gulf states to supply the spindles of New England, and coal from the Pennsylvania mines goes down to supply the plantations of the South. "The statistics of internal trade movements show that both the outgoing foreign and the domestic commerce of the country depend principally upon the industries engaged in the production of these staple products. These industries are known as the fundamental or extractive industries, and include agriculture, mining, stock-raising, lumbering, and fisheries. Manufactures and merchandise contribute a comparatively minor portion of the total tonnage carried in a given year. The dividend-earning tonnage of the western roads, for example, is found chiefly in the volume of the grain and cattle shipments. Lake transportation is supported primarily by ore, grain, and coal freight. The southern railroads rely on cotton, lumber, coal, and fruits for



Prepared by the Bureau of Statistics, Department of Commerce and Labor.

PLATE 2.

their prosperity." [1] Manufactures and merchandise constituted only about eighteen per cent of the total railroad tonnage originating on the lines in the fiscal year ending 1899.

The vast scale of this geographical specialization of products involves enormous movements of freight. It has brought about the evolution of the American railroad system. Among the six sections laid down on the cartogram, the most central position is held by the corn and winter wheat division. This, as we saw in the last chapter, is also the area of greatest urban and industrial development, manufacturing activity decreasing from the east towards the western limit. It is the area of greatest concentration and distribution of products. It contains eight out of the eleven leading grain markets (Chicago, St. Louis, Toledo, Milwaukee, Kansas City, Cincinnati, Peoria, and Detroit, named in the order of their importance) of this country, and all of the four or five most prominent stock centers, as we have seen. It is the area of most extensive coal, iron, and steel production, which with bread and meat constitute the fundamentals in modern economic life. Hence in this important central division the greatest movements of internal commerce occur; it has become the channel of practically all the great trunk lines reaching from the interior to the Atlantic seaboard. This channel is constricted on the north by the downward bend of the Great Lakes and the geographical location of the Mohawk depression, and on the south by the rough upland of the Cumberland Plateau, the determining line of the Ohio valley, and the central gaps of the Appalachian Mountains. Norfolk and Boston, together with all the intervening ports, are its eastern termini on the Atlantic coast. To the west, nine different railroad lines extend to the foot of the Rockies within the limits of the thirty-seventh and forty-third parallels, so that a railroad map of Kansas and Nebraska looks like a striped fabric. The meridional division of the sections of production in the Far West allows to the six overland railroads a wider north and south distribution, so that their course is determined chiefly by the best passes through the Rocky Mountains and the location of the few good ports on the Pacific. One road will ship eastward fresh fruit from southern California and wool from Arizona, while a more northern line will bring these same products from Oregon and Montana.

[1] Internal Commerce of the United States, *Summary of Commerce and Finance*, p. 1630.

The great breadth of the United States and its highly favored interoceanic position has given to its railroads a predominant east and west direction. The expansion of the American people from seacoast to the interior, and from the interior on to the sea again, has been repeated in the history of American railroads, but at a tremendously accelerated rate. The star marking the center of population was poised on the summit of the Alleghenies in 1830 while infant railroads only here and there were crawling up the first easy grade of the Atlantic coastal plain. Twenty-one years later a line of rails stretched through central New York to Lake Erie, and the Baltimore and Ohio road had reached an equally western point in Piedmont, West Virginia (79° W. L.), close on the trail of the star, which was moving down the sunset slope of the Allegheny Plateau towards Parkersburg and the Ohio. But eight years after that, an overland express drew in to the shores of San Francisco Bay, while the star still lingered in the valley of the upper Ohio.

Railroad development in the United States proceeded with amazing rapidity, so that it soon outstripped that in all other countries. The great size of our territory, its long distances, made railroad communication more necessary than in Europe. Its simple continental build, yielding long stretches like the Atlantic plain, the Mississippi valley, the prairies, and the Pacific valley, was favorable to railroad construction because of the relatively few obstacles which it presented. Moreover, the oneness of our country, as opposed to the political dismemberment of Europe, was conducive to the operation of great through lines and that consolidation of interests which early appeared.

In the first decade of their history, these roads, which in forty years were to rib the continent with steel, were merely accessories to established routes of water travel; or they united some adjacent interior town with the seaboard; or they served as a short cut across the land between two ports which had previously established active intercourse by more devious coastwise communication.

Among those railroads whose objective was an established waterway, we find the short line running sixteen miles from Carbondale to Honesdale (1828) and connecting the Lackawanna coal-mines with the Delaware and Hudson Canal; the line of seventeen miles from Albany to Schenectady, open in 1831 to accommodate passengers on the Erie Canal by saving them the

long detour of the waterway between these two points; the road southward from Saratoga to Schenectady (21.5 miles) opened in 1832, and the branch off this line from Ballston to the Hudson at Troy (25 miles), completed in 1835; the road from the head of Lake Cayuga southward to navigation on the Susquehanna River (34 miles), opened in 1834; the railways over the high land between Philadelphia and Columbia on the lower Susquehanna (81 miles), and the Portage Road over the summit (2491 feet elevation) of the Allegheny Mountains (36 miles) just east of Johnstown, both opened in 1834, to form links in the canal route joining Pittsburgh and Philadelphia; the Baltimore and Ohio, which in 1833, after a piecemeal construction, extended to Harpers Ferry (81 miles) on the Potomac, and there tapped the canalled river whereby passengers avoided the long detour of water travel around the end of the Potomac peninsula; the short independent road from Harpers Ferry up the Shenandoah Valley to Winchester (32 miles), opened in 1836; the little roads in Louisiana from Port Hudson on the Mississippi (21.5 miles) northeast to Clinton, opened in 1833, from Bayou Sara in the same vicinity to the town of Woodville (27.5 miles), opened in 1842, and that from New Orleans running eight miles to Carrolton, opened in 1835.

All these roads, with the exception of two, are distinguished by very short length, which emphasizes their merely auxiliary character. But the last one to be mentioned in this class, the road between Boston and Albany (1842), owing to the lack of inland waterways in New England, had to strike two hundred miles across hill country and river valley to reach the growing western commerce which was coming out by the Erie Canal. This road, therefore, owing to the sidetracked position of Boston in relation to the great interior routes of the country, had to leave the convenient level of the tidewater and lowland, and take a more difficult upland course to the debouchment point of the Erie Canal. Hence in point of length, which is the measure of urgency, it resembles the Baltimore-Potomac and the Philadelphia-Columbia lines; all three tap established routes to the productive trans-Allegheny country.

The second class of early railroads comprises those aiming to connect inland points with the seaboard, which commands the world's great waterway. They are characterized as a whole by greater length than the first class. Among them we find the

germ of the Boston and Albany, the road running from Boston to Worcester (44 miles), opened in 1835 and extended to Springfield in 1838; the line from Boston to Lowell (26 miles) in 1835; from New Haven to Hartford in 1839 and extended along the easy route up the well-populated Connecticut valley to Springfield in 1844, to Greenfield in 1846, to South Vernon on the Vermont border in 1849, whence it branched off up the little Ashuelot River to Keene, New Hampshire, in 1851; the road up the Housatonic valley from Bridgeport, Connecticut, forming a conjunction with the Boston and Albany route at West Stockbridge on the New York state line in 1842; the Philadelphia and Reading road (98 miles) and a branch from Lancaster on the already established Columbia and Philadelphia line running off 54 miles to Harrisburg, both opened as early as 1838, and that in spite of competing canals; a line from Portsmouth at the mouth of the James River in Virginia running 80 miles back from the coast to Weldon, North Carolina, opened early in 1835; one from Charleston, South Carolina, to Hamburg on the Savannah River opposite Augusta, opened in 1833, when its 135 miles made it the longest continuous line in the world, and extended by a branch to Columbia in 1840, whereby the cotton of the interior could be more readily concentrated in the chief port of the southern Atlantic seaboard; and finally another road subserving a like purpose, opened in 1841 throughout the 192 miles between Savannah and Macon, Georgia.[1]

The third class of early railroads was designed to connect coast points, and therefore, from Pamlico to the eastern end of Long Island Sound, had to compete with the inside coast passage of canal and bay and the highway of the open ocean. But the circuitous ocean route from point to point and the slow progress through the canals, winter storms on the outside passage and ice blockade on the inner channels, necessitated more direct and reliable communication. Hence we find the early development of what we may call the coast or "fall line" railroad. The dates of construction of this geographical line of roads, made piecemeal by different companies, as were all early ventures of this sort, are instructive as indicating the intensity of water competition, which varied with the directness of the sea route. The railroad from Boston to Providence appeared as early as 1835,

[1] For an historical study of these roads in some detail, see U. B. Phillips, *A History of Transportation in the Eastern Cotton Belt to 1860.*—Ed.

because it cut off the long detour of the sea-way around Cape Cod. It was supplemented in 1837 by a road from Providence to Stonington, Connecticut, which landed passengers and goods at the entrance of the protected course of Long Island Sound and thus avoided the dangerous navigation around Point Judith at the southern extremity of Rhode Island. Otherwise this road, which ran along within two miles of the coast in order to avoid the hundred feet elevation line of the interior, did not greatly shorten the distance between Providence and Stonington. The Sound route from Stonington to New York is safe and direct. Hence we find the railroad from New York to New Haven did not open till 1849, and that from New Haven to New London till 1852. Along the eastern shore of Massachusetts, also, where exceptional maritime conditions had produced a race of seamen, railroads developed somewhat slowly in competition with coastwise communication. The Eastern Railroad, consolidated from several minor lines running directly northward near the coast, was opened between Boston and Portsmouth, New Hampshire, in November, 1840, and extended two years later to Portland, Maine. This road served the manufacturing area of eastern Massachusetts and competed with the longer sea route around Cape Ann; but its branch running from Beverly out to Gloucester and Rockport on the extremity of this peninsula was not constructed till 1847. Plymouth waited for rail connection with Boston till 1846.

South of New York Bay, more devious sea routes between the leading tidewater cities, due to the long projections of the New Jersey, Maryland, Virginia, and Carolina peninsulas, and incidentally the location of the national capital on the medial one of the series, early determined the construction of a chain of railroads across their base. The deep-running estuaries of this stretch of coast necessitated the location of the railroad approximately along the "fall line" from New York south to Goldsboro, North Carolina; but there it left the one hundred foot elevation line and dropped down to Wilmington at the mouth of the Cape Fear River.

Following this road in detail, we find that the earliest link in the chain reflected the active intercourse between New York and Philadelphia. It ran from Camden, on the Delaware River just opposite Philadelphia, 64 miles to South Amboy on Raritan Bay, was begun in 1830 and finished in 1834, four years before

the completion of the Delaware and Raritan Canal. In 1839 a second railroad (31 miles) was opened between Bordentown and New Brunswick, the termini of the canal, parallel to the first road in its eastern half. A line opened between Jersey City and New Brunswick (34 miles) in 1838 completed the communication with the Hudson River and New York.

From Philadelphia southward the railroad, following closely the line of one hundred feet elevation, was opened in 1837 through Wilmington, Delaware, to Baltimore; there it connected with the Washington branch of the Baltimore and Ohio which had already been in operation three years. From Washington the Potomac, owing to its southward course as far as Acquia Creek, long persisted as a link in the line of communication between the national capital and Richmond. A road was opened in 1837 between Richmond and Fredericksburg on the Rappahannock near the bend of the Potomac, but not till 1872 was the line extended to Washington and the steamer trip from Acquia Creek dispensed with. A writer in 1873 deplores this as the sacrifice of "one of the most pleasurable features of the trip between Washington and Richmond."

From Richmond a short line (22 miles) was finished southward to Petersburg in 1838, to complete connection with an existing road (since 1833) which ran closely along the one hundred foot elevation line across the base of the deep peninsula of southern Virginia directly southward through Emporia to Weldon, North Carolina. Difficulty of communication down the rivers of North Carolina, the long detour around Albermarle Sound, Chesapeake Bay, and the James River had undoubtedly dictated this cut-off road. The continuation of the line southward through Goldsboro to Wilmington was not made till 1840, a fact which reflects the slow economic development of North Carolina at that time.[1]

To the geographer the interesting fact in this long chain of railways from New York City to southern North Carolina is its close adherence to the line of one hundred foot elevation. This is the line marking cities, mills, and the head of navigation on the rivers or their estuaries, retreating farther and farther from the seaboard from the mouth of the Hudson southward. This western limit of the coastal plain presented few problems to railway building beyond the bridging of the

[1] See H. D. Dozier, *A History of the Atlantic Coast Line Railroad.*—Ed.

wide drainage streams, which in early days were crossed by ferries from station to station. The smooth, even slope of the Piedmont upland and the broad trough of the Appalachian Valley also offered few obstacles. Hence as the development of the hill and interior valley country progressed, these natural longitudinal routes were traced by a line of rails from northern Georgia to the Potomac. The Piedmont road, now the Southern system, runs at an elevation between five hundred and one thousand feet from Manassas Junction, whence it connects with Washington, southwest through Culpeper, Orange, Charlottesville, Lynchburg, and Danville in Virginia; Greensboro, Salisbury, and Charlotte, in North Carolina; Spartanburg, Greenville, and Westminster, in South Carolina, to Atlanta, Georgia.

Piedmont railways are a feature of every map. They mark the limit set by nature to economic construction of great routes of transportation along the flanking plain. Their elevation varies with the magnitude of the mountain system which they trace, and the surface features of the plateau base which they traverse. We see the piedmont railroad of the Atlantic slope reproduced in the piedmont line at the eastern foot of the Rockies, running from Calgary (3388 feet elevation), at the base of the mountain wall in western Alberta, southeast through western Montana, where along the sources of the Missouri River, the Yellowstone, and the Big Horn it rises at times to an elevation of five thousand feet; thence south along the Laramie Range to Cheyenne, and still at the same altitude along the eastern base of the Colorado Rockies through Denver and Pueblo to Las Vegas, whence it turns westward across the mountains by the old Santa Fé Trail to the valley of the Rio Grande, to follow this stream southward to El Paso. . . .

The period from 1830 to 1860 saw six railroads constructed across the Appalachians at various points between the Mohawk valley and northern Georgia, where the upland system dwindles away into low hills offering little obstruction to railway building. The roads followed with slight variations the lines of least resistance settled upon by the old trails of Indian, trapper, and western pioneer, and the later routes of proposed canals which were constructed in whole or in part, or were abandoned altogether as impracticable. From New York to the southern boundary of Virginia the lower altitude and dissected character of the Appalachian system afforded the first routes for railways which

were economically possible; but from Virginia southward for a stretch of three hundred and fifty miles, the massive wall of the Great Smoky Mountains effectively discouraged the construction of a railway over this barrier till 1882.

The route which saw the only through canal system across the Appalachians saw naturally the first transmontane railroad. From the little seventeen-mile road from Albany to Schenectady as an embryo developed the different stages of westward railroad advance along the line of the Erie Canal. Year by year the links in the chain were added,—Utica and Schenectady in 1836, Syracuse and Utica in 1839, Auburn and Syracuse in 1838, Rochester and Auburn in 1841, Rochester, Lockport, and Niagara Falls in 1838. In 1843 a traveler could cross the state of New York by rail from Buffalo to Albany, but he was carried by sixteen different companies. In 1851 the Hudson River railroad completed rail connection between the Atlantic seaboard and Lake Erie.

To New York belongs the honor of having constructed also the second railroad across the mountains. The Erie road, taking advantage of the dip in the mountains south of the Catskills, started from Piermont on the lower Hudson, taking seven years to crawl over the Highlands to Port Jervis on the Delaware, whence it pushed rapidly westward along the valley of the Susquehanna and its western tributaries, and over the second watershed to Dunkirk on Lake Erie, in 1851, nowhere reaching an elevation of eight hundred feet. Thus in this year New York had two lines from the harbor of the Hudson to the western lake.

The Erie was followed closely by the Pennsylvania, and Baltimore and Ohio railroads, opened respectively in 1854 and 1853. The impracticability of a canal between the Potomac and the Ohio forced the development of the more southern road. It reached the old pioneer station of Cumberland, at the northern bend of the Potomac, as early as 1842; but from that point the discouragement to construction over the rough surface of the Allegheny Plateau and the high altitude to which it had to ascend (2620 feet) retarded its completion to Wheeling and the Ohio till January of 1853. The Pennsylvania line extended westward from Harrisburg, which since 1838 had had rail connection with Philadelphia, followed the canal route up the Juniata River to Huntingdon and Holidaysburg, passed thence over the summit of the mountains to Johnstown and down the valley

of the Conemaugh River to the Allegheny, and down this stream to Pittsburgh. Difficulty of construction over the main crest of the mountains delayed the road for two years, so that through connection was not made till 1854.

With the completion of these four roads across the mountains, the competition of rail and waterways began, but at first very slowly. In 1852 the through freight east on the Erie Canal was twenty-six times that carried by the Central and Erie lines, but in 1853 it was only fifteen times greater. In one year more the absolute decline of tonnage on the canal began to be alarming, so much was being diverted to its rivals. In Pennsylvania the inadequacy of the canal system as a transit route over a mountainous country had long been apparent, and its early (1857) purchase by the railroad company eliminated the last vestige of competition it might have offered.

In the mean time, the opportunity for a railroad around the southern extremity of the Appalachians along the route known to the early Cherokee traders was being exploited, and a chain of many links from Savannah and Charleston through Atlanta and Chattanooga, the two "gate" cities, to river navigation at Nashville was completed in 1854, while another line from Chattanooga through Stevenson, Alabama, to Memphis opened connection with the Mississippi in 1858. The lack of river communication along this east and west route, the impracticability of Gallatin's proposed canal, the adaptation of the face of the country to railway building, and the need of access from the southern states of the Mississippi basin to the Atlantic seaboard, all combined to push the construction of this southern line.

Chattanooga had now a central position on a great route east and west, and in its rear lay the Appalachian Valley, affording a natural route of communication with the northeast. Hence we find that the next transmontane line, though starting in Virginia, had Chattanooga for its objective. From its seaboard terminus, Norfolk, at the entrance of Chesapeake Bay, it ran westward along the low watershed between the James and Roanoke rivers to Lynchburg, which it reached in 1854. Thence it passed through the Blue Ridge by the water-gap of the James, turned southward up the Valley of Virginia by the path of the old Wilderness Road to Bristol on the upper Holston, in 1857, and down the valley of East Tennessee to Knoxville and Chat-

tanooga by 1858. Though so late in being constructed, its value as a link in the great through road between New Orleans and the eastern cities was soon appreciated. Subsequently it became a main trunk line from which one branch turned off eastward at Morristown up the French Broad River to Paint Rock, on the western slope of the Great Smoky Mountains, in 1861, and there in 1882 formed a junction with a line which came up from Salisbury on the eastern piedmont railroad and crossed this forbidding range by way of Swannanoa Gap and the upper valley of the French Broad. Another branch from the Tennessee valley railroad turned westward to Cumberland Gap, and there united in 1890 with another line passing down to central Kentucky; and a third quite recent one turned westward a little farther north at the elbow of the New River in western Virginia, passed down that stream for about thirty miles, and over the watershed to the Tug Fork of the Big Sandy by the old war-trail of the marauding Shawnees, and continued down that river to the Ohio and the railroads traversing its banks.[1]

In the mean time, however, before these branch roads from the Great Valley thoroughfare had multiplied the rail routes over the Appalachians, another road was planning to utilize the pioneer trail from the western sources of the James over the mountains to the Greenbrier branch of the Kanawha. As early as 1857 a road passing along the head streams of the Shenandoah and the James had reached the base of the main Allegheny range at Covington. The extension to navigation at Huntington on the Ohio was undertaken entirely by the state of Virginia, which still cherished its old dream of being a great transit region, a dream which the river paths of the Virginia mountains had awakened in the minds of Washington and Jefferson. The difficulty of construction down the New River cañon and the interruption of the Civil War retarded the construction of the work till 1873.

Three out of the four earliest trans-Appalachian railroads, as we have seen, followed the routes of finished or unfinished canals; and even after reaching the interior basin of the country, the railroads continued to search out the domain of the waterway as if to challenge its competition. The geographical facts

[1] The lines referred to in this paragraph are those of the Southern Railway and Norfolk and Western. The railroad discussed in the following paragraph is the Chesapeake and Ohio.—Ed.

are these. The waterways, whether lake or canal, traced the line of least elevation and hence least resistance. The westward trend of the Great Lakes brought the terminus of the water route near to the natural concentrating channel of the Mississippi River, and the western canals united the Lakes with the Ohio. Both lakes and canals, Ohio and Mississippi, were dotted with the largest cities of the western country. Commerce had been started in its course along these waterways. The limitation of canal navigation, due to shallow draft vessels and the short open season in these northern latitudes, soon proved a serious stumbling-block as western resources were developed and commerce grew. The lines of traffic which the canals had created the railroads fell heir to; the transmontane roads did not begin to come into their full heritage, however, till railways began to spread over the interior basin between the Ohio and the Lakes, and the produce of western farms could be loaded first into freight cars instead of canal-boats. Thus the strategy of transportation patronage lay in the question of reloading. When railroads by their wide expansion had gained this point, by their rapidity and reliability they surpassed their rival. Hence we find the western trunk lines seeking the path of the waterways.

Just as Ohio was the first western state to follow the example of New York in canal building, so now she was the first to imitate her in the construction of railroads. Here again geographical location on the constricted area between free navigation on the Ohio and the Great Lakes was a potent factor in transportation development. It made a short passway for the steel arteries of commerce as before for water channels. The Mad River railroad, begun in 1832, was opened in 1848 between Sandusky on Lake Erie and Dayton, a city which already had canal communication with the Lake through Toledo. This road in connection with a previously (1846) completed line, the Little Miami between Springfield and Cincinnati, which was also in canal communication with Toledo, formed the first through line from the Ohio to Lake Erie. A second line in operation in 1851 connected Columbus with Cleveland, and a third opened communication between Cleveland and Pittsburgh in 1852.

Thus Ohio had three railroads across the state from north to south when the New York trans-Appalachian lines began to push westward along the southern rim of Lake Erie, from Buffalo to Erie, Pennsylvania, in February, 1852, from Erie to Cleve-

land later in the same year, and from Cleveland to Toledo in January, 1853. This was the last link in the line between New York and Chicago, because the approximation of the heads of Lakes Erie and Michigan had some years before suggested the plan of a railway short cut across the base of the Michigan peninsula. This line, first projected to run from Monroe just north of Toledo over to New Buffalo (a suggestive name) on Lake Michigan opposite Chicago, was pushed half of the distance to Hillsdale in 1843; but when reorganized under a new company was diverted to Chicago and the road from lake to lake opened in 1852 with the eastern terminus at Toledo.

No sooner had the New York roads connection with the lines of the Lakes and the Ohio basin than an enormous increase of their commerce ensued. To this the state of Ohio contributed a large measure. In spite of slack water navigation on its canals, traffic had previously followed its drainage streams, owing chiefly to the different areas of production in the state. About two thirds of the wheat had sought an outlet by the Lakes and the Erie Canal; corn, which was grown largely in the southern part of the state, and all other provisions went out by the Ohio River to New Orleans, whence they were transported to the Atlantic seaboard. Of the exports of beef from Cincinnati in 1851, the year prior to the through railway communication with the East, 97 per cent went down the river and only 2 per cent northward to the Lake. Of the Indian corn, the river traffic got 96 per cent and the Lake 3 per cent; of the flour, the former got 97 per cent and the latter 1 per cent. Lard, pork, and bacon sought these outlets in about the same proportion. A small quantity of all these articles supplied the demand in the growing city of Pittsburgh. The heavy movement of provisions to the South was due in part to the fact that animals could not be slaughtered till cold weather had set in, when navigation on the canals was closed. Hence the provision trade was readily diverted to the railroads, and with the growing demand in the eastern markets attending increase of population and of industrial development, it soon came to constitute an important part of the through traffic.

When the Pennsylvania road completed its connection with Pittsburgh, its rail communication with Cleveland was already established. The next year after the Baltimore and Ohio came into Wheeling saw a line opened from Bellaire in Ohio, nearly

opposite Wheeling, westward to Columbus; and another road, branching off northwestward from this at Newark, established communication with Sandusky and the Shore line in 1856. Thus the region of the Ohio and the Lakes was rapidly drawn into the sphere of influence of the four eastern roads.

But beyond lay the Mississippi, and already the traffic of this great waterway was being tapped by the Chicago and Rock Island railroad, which was completed in 1854. Prior to this time the canals from Lake Michigan had had little influence in directing the Mississippi trade eastward to the Lake route. All the produce along its western tributaries and most of that from its eastern bank went down the river to New Orleans. The current of the Illinois River carried southward most of the products of central Illinois, and only those from the northern part of the state sought the Lake outlet. But from this time the stream of traffic was deflected at right angles toward the eastern markets. Between 1855 and 1856 Chicago became the center of roads radiating to the Mississippi,—to Galena, Alton, Burlington, Quincy, and the mouth of the Ohio. In 1858 the Milwaukee and La Crosse road struck the Mississippi higher up. The next step was to the Missouri, from Hannibal to St. Joseph through northern Missouri, in 1859, and an extension of the Galena line through Iowa to Council Bluffs in 1866.

The intense localization of our industrial and urban development in the northeastern part of the United States, the concentration here of our great commercial ports, and the distribution of our chief foreign markets across the Atlantic yet farther east in Europe, were the main factors in determining the early east-and-west direction of our principal railroads. When the Mississippi valley was finally opened to the eastern lines, railroad building progressed rapidly, finding in its gentle slopes and low watersheds slight obstacles to construction. The bridging of its wide streams was one of the most serious problems. We notice to-day certain large features of railroad distribution in the United States. The most striking of these is the coincidence of the area of intensest urban development with that of the greatest railroad development. Here the network of steel rails is thickest. It tells the story of incoming raw materials and of outgoing finished commodities, of many mouths to feed, bodies to clothe, houses to build, and of many factories to be supplied with fuel. We notice particularly how all the great lines from

the Northwest have to turn the corner sharply at Chicago, owing to the deep indenting inlet of Lake Michigan, and thus produce a congestion of railroads which has been the making of that city. We next observe a thinning of this steel network in the agricultural South and the arid West; the occurrence of certain "vacant spots" where the mesh becomes still wider, spots already familiar as areas of sparse population, in the swamp region of southern Florida, in the lumber region of northern Maine and Minnesota, in the barren Ozark Mountains of Missouri and Arkansas, and in the rough upland of the Cumberland Plateau in West Virginia, Kentucky, and Tennessee. The few railroads which enter the latter region, with only one exception, strike across the axis of the Appalachians, indicating their primary character as transit lines. The western base of this mountain system, owing to the irregular limit of the Allegheny and Cumberland plateaus, has developed no well-defined piedmont railroad such as outlines the eastern foot of the Appalachians.

We notice lastly beyond the eastern margin of the arid belt a marked predominance of east-and-west roads and a sudden decrease, almost a cessation of railroads running north and south. West of this limit we find only three such roads,—the Cordilleran piedmont already mentioned; a second line running south from Helena and Butte, Montana, diagonally across the axis of the Rocky Mountains and down the head stream of Snake River to Fort Hall, whence along the western base of the Port Neuf and Wahsatch ranges to southwestern Utah it forms the piedmont road of this rim of the Great Basin; finally the Pacific Valley line running from Puget Sound along the old trails from the Nisqually to the Columbia and from the Willamette to San Francisco Bay, and on up the San Joaquin valley to Mojave in southern California.

Across the belt of the Great Plains many lines strike out boldly for the Rocky Mountains, following sometimes the banks of the parallel drainage streams, more often seeking the solid ground of the watersheds between. Only six, [now seven] [1] pass

[1] These seven (from North to South) are the Great Northern; the Northern Pacific; the Chicago, Milwaukee and St. Paul; the Union Pacific (together with three lines from the Salt Lake basin, the Oregon Short Line to the Columbia River Basin, the original Central Pacific line of the Southern Pacific system, and the Los Angeles and Salt Lake); the Denver and Rio Grande-Western Pacific system; the Atchison, Topeka and Santa Fé; and the Southern Pacific, which joins up with the Texas and Pacific and Rock Island via El Paso. There are also three Canadian transcontinental lines: the original Canadian Pacific, and the Canadian Northern, and the Grand Trunk Pacific lines of the Canadian government system.—Ed.

the mountain barrier and reach the Pacific; but in view of the youth of the country, its arid and mountainous character, and the sparsity of its population, this number speaks eloquently for the power of attraction of two opposite coasts. Its situation between two oceans makes of the United States a great transit land; hence the amazing development of the transcontinental lines. The alternative of this overland transportation from New York to San Francisco, a distance of three thousand miles, is a voyage over four times as long around the Horn. The wide separation of the Baltic and Pacific coasts of Russia, with the choice of a long voyage through arctic or through tropical seas, has forced upon the Muscovite the construction of the great Siberian railroad. A similar situation in Canada called forth its overland road. All these great lines had a political as well as a commercial motive; the political was immediate, however, and the commercial was largely a matter of faith in the future. The Russian and Canadian lines were purely government undertakings; but in the United States political urgency dictated a gigantic system of land grants and subsidies to the transcontinental roads, which, owing to the character of the country which they traversed, were most expensive in construction and along certain stretches could probably never count upon the support of local traffic.

These overland railroads, for a great part of their way, keep to the old California, Oregon, Santa Fé and Gila River trails. The more northern ones follow for shorter distances the footsteps of Lewis and Clark and other early explorers. But the engineer straightens the routes which nature made and avoids detours which were the trader's only paths. The zonal distribution of these transcontinental roads is interesting. We find two [now three] northern lines starting from the western extremity of Lake Superior and contained for all their distance between the forty-sixth and forty-eighth parallels. In the stretch from the Red River of the North to Puget Sound eight cross-lines connect them with the Canadian railways of the Northwest Territories and British Columbia, arteries through which so much rich American blood has been poured into the infant giant of the Far North. The main lines are dotted every few hundred miles with a railroad plexus,—Duluth, Fargo, Moorhead, Helena, Spokane, Tacoma, and Seattle, all of them falling near the forty-seventh parallel, and marking the directness of the connection between the eastern and western termini.

The same phenomenon is observed in the other overland routes. The next one to the south takes its course almost along the forty-second parallel from Chicago through Council Bluffs, Omaha, Cheyenne, and Ogden to the northern end of Great Salt Lake; thence it deviates from its adopted path, sending one branch off along the old Oregon Trail to the Columbia and Portland, another southwest by the California Trail to San Francisco Bay. These two Pacific branches from the Salt Lake oasis promise in the near future (1904) to be augmented by a third, which will follow approximately the old Spanish Trail southwest across the Mojave Desert and Cajon Pass to Los Angeles. Thus Salt Lake City will become preëminently the railroad center of the Great Basin. Already it is entered from the east by the fourth trans-Rocky railroad, which, adhering closely to the thirty-ninth parallel, moves straight across the country from St. Louis through Kansas City, Pueblo, and Gunnison to the Green River just below the outlet of Desolation Cañon, and thence turns sharply northward to join the Wahsatch piedmont road at Utah Lake [extended to San Francisco by the Western Pacific].

The destiny of the Salt Lake oasis as a concentrating point is assured, because for a stretch of almost two hundred miles across northwestern Arizona the impassable cañon of the Colorado River acts as a barrier to deflect overland railroads either northward towards Salt Lake or southward below the outlet of this mighty trench. Hence we find the next overland route leading directly west along the thirty-fifth parallel from Albuquerque, New Mexico, to Mojave, California, where it unites with the Pacific Valley line. This Santa Fé system is the only road across the great western highlands which has to make a distinct bend, either north to Pueblo or south to El Paso, to establish its eastern connections. The desolate expanse of the Llano Estacado of northwestern Texas, flanked on the west by the barren mesa-dotted highlands of eastern New Mexico and on the east by the undeveloped area of the Indian Territory, has not proved an inviting field for railroad enterprise.

Farther south, the Gila River depression, the gap in the mountain wall at El Paso, the grass highlands of central Texas, and direct connection with the earlier roads eastward from the Mississippi valley around the southern end of the Appalachians, have determined the line of the remaining transcontinental

route. This also adheres pretty closely to one parallel, the thirty-third, near which it leaves the Mississippi River and passes through Dallas and Fort Worth in Texas; but then it drops southward one degree for the mountain gap at El Paso and the easy route over the Sierra Madre Plateau, followed by Cooke's wagon-trains in 1846. It strikes the thirty-third parallel again on the Gila River, and this line it keeps to southern California, where mountains deflect it north to Los Angeles and bar it from San Diego, its natural Pacific terminus.[1]

The striking facts in these overland railroads are their distribution in northern, central, and southern pairs; the directness of the lines of connection from east to west; the development of an interior concentrating point in the Salt Lake oasis and of two marginal ones on the Pacific. One of these is located near the Canada boundary about Puget Sound, which receives three of the American transcontinental roads and is in close communication with the Canadian Pacific where it issues from the mountains at the mouth of Fraser River; and the other is near the Mexican frontier at Los Angeles, which to its two overland railroads will in the immediate future add a third coming down from central Utah. This last Pacific entrepôt is as yet only in its infancy, but the acquisition of its new link with the East and the improvement of the harbor of San Pedro Bay will do much to stimulate its development. To San Francisco remains always the advantage of its central location and its direct line of communication with the northern Atlantic seaboard.

The Pacific coast is remarkable for the fairly even distribution of its active ports along all its great length,—Seattle and Tacoma at about 47° 30′ N. L., Portland at 45° 30′, San Francisco at 37° 45′, and San Pedro, the harbor of Los Angeles, at 33° 45′. In this it presents a striking contrast to the Atlantic coast, which has all of its important seaboard points crowded together between Boston (42° 20′ N. L.) and Norfolk (36° 50′ N. L.), a stretch of five and a half degrees of latitude as opposed to nearly fourteen degrees between extreme ports on the Pacific. The explanation of this phenomenon is to be sought in the various geographic influences already discussed, which have determined economic development and railroad distribution in the whole northeastern section of the United States. Until the last few years the active

[1] The San Diego and Arizona, completed for through traffic in 1919, now brings the Southern Pacific to this "natural terminus."—Ed.

Atlantic ports were contained within even narrower limits; the inclusion of Norfolk represents a recent expansion from Baltimore southward, concomitant with growing commercial activity in the southern states. But the great seaport development which the future holds for the eastern half of our country is to occur along the Gulf coast, whither the interior railroads are already turning to seek an outlet. . . .

CHAPTER III

THE PACIFIC RAILROADS AND THE DISAPPEARANCE OF THE FRONTIER IN AMERICA [1]

Within recent years it has become a commonplace in American history that the influence of the frontier is the one constant to be reckoned with in accounting for the development of American life during its first century of independent existence. The frontier has been defined so as to describe the line dividing a western area, chiefly unoccupied by whites, and an eastern region given over to an increasing agriculture. In the face of an advancing population it has retreated rapidly from the fall line to the semi-arid plains, where it finally disappeared in the decade of the eighties. Its influence did much in directing American life during its period, and since its passing new national problems and ideals have marked a change in both people and government of the United States.

The passing of the frontier is the phenomenon of the eighties, now generally accepted, yet like most matters of recent history not really demonstrated. Its best historian remarked, in 1893, that "now, four centuries after the discovery of America, at the end of a hundred years of life under the Constitution, the frontier has gone, and with its going has closed the first period of American history." [2] Its passing is not, however, undemonstrated because of its difficulty, since the facts of the years from 1880 to 1885 throw themselves naturally into groupings whose logical key is this idea of the completion of the first period of national growth.

There have been two frontiers in the United States that have controlled periods of national thought by their duration. In the forties and early fifties a broad, sparsely settled frontier lay between the old East and the Missouri and Mississippi settlements. Wagon roads and canals connected the distant borders,

[1] From Frederic L. Paxson, *Annual Report of the American Historical Association*, 1907, vol. I, pp. 105–118. Reproduced by permission.

[2] F. J. Turner, "The Significance of the Frontier in American History," in *Annual Report of the American Historical Association*, 1893, p. 227.

but the resulting unity was so slight that the completion of the trunk-line railroads in the fifties worked a revolution in economic and intellectual conditions. Just how far the northern spirit that maintained the Union is the result of these developments in transportation no one has measured.

The crossing of this old eastern frontier left but one difficult area in the United States. From the western boundary of Missouri, Arkansas, and Iowa to the Pacific States stretched the great American desert with its deficiencies in rainfall and its scanty native population. So long as this area remained intact the frontier continued to exert its dominant influence, but when it succumbed to the pressure of economic advance the frontier was gone forever. The years from 1869 to 1884 cover the final period in the life of the last frontier. The beginning of the end comes with the completion of the Union and Central Pacific railways in 1869; the period closes with the opening of the other Pacific railways in 1882-1884.

The great American desert became a reality in frontier life as early as 1819. Until this time the edge of the frontier had been east of the Mississippi River, and its people had depended on the East. But the settlement of Missouri brought population to the bend of the Missouri River by 1819, and within the influence of an overland trade that beckoned from the Spanish towns at Santa Fe. This Santa Fe trade was an important element in frontier prosperity from the erection of Fort Leavenworth in 1827 until the Mexican War. In these years the route across the plains and along the Arkansas and Purgatory rivers was worn deeper and deeper. In the middle of the forties the call of the Northwest drew another trail from Fort Leavenworth along the Platte, by South Pass, and down the Snake River into Oregon, while the diggings on the Sacramento tempted the Forty-niners across the Nevada desert and along the Humboldt into California. When the Mexican war was over Congress was facing a territorial problem on the Pacific coast that was made more difficult by the existence of the great frontier which divided the centers of American life. Yet already the overland trails, inadequate as they were, had revealed the possibility and early necessity of railroad routes extending from ocean to ocean.

When the agitation for a Pacific Railway commenced there were these two beaten tracks connecting the Missouri River and the Pacific. Trappers and explorers had pointed out the possi-

bility of other routes, but the pressure of population along the easiest channels of communication had developed the prominence of the Missouri bend, between Independence and Council Bluffs, as the chief eastern point of departure. Hence the two trails from Fort Leavenworth by the Platte and Arkansas carried most of the Pacific traffic that journeyed overland. By 1850 the systematic lobbying of Asa Whitney and his allies had educated the public to an acceptance of the railway idea, but the emergence of slavery sectionalism had made a choice among particular routes impossible.[1] Until after 1853 the only progress made was the survey of five available routes ordered by the army appropriation bill of that year, and until after the elimination of southern influence, in 1861, no further step was taken. In all these years, while the old eastern transportation frontier was in process of demolition, the rivalry of New Orleans, Vicksburg, Memphis, Cairo, St. Louis, and Chicago, and their hinterlands kept the western frontier unbroken.

In the history of the frontier the Union Pacific Railway marks the beginning of the end. Chartered in 1862, reendowed in 1864, started on its race for lands and subsidies in 1866, it finally completed a through track across the continent in 1869. The celebration of completion at Promontory Point on May 10, 1869, was not unnoticed even in its own day as a national act. The public was generally conscious that a great event had taken place; cities devoted themselves to open demonstration; Bret Harte broke into song under its influence. But in reality the frontier was not destroyed. From a narrow strip across the plains Indians had been pushed to one side and another and a single track had crossed the mountains, but north and south great areas remained untouched, for the demolition of the frontier had only just begun.

The effort that finally destroyed the continental frontier differed from all earlier movements in the same direction in that it was self-conscious, deliberate, and national. "The frontier reached by the Pacific Railroad, surveyed into rectangles, guarded by the United States Army, and recruited by the daily immigrant ship, moves forward at a swifter pace and in a different way than the frontier reached by the birch canoe or the pack

[1] The genesis of the Pacific railway idea is traced in J. P. Davis, *The Union Pacific Railway*, pp. 1-110, and in E. V. Smalley, *History of the Northern Pacific Railroad*, pp. 1-112.

horse."[1] The idea of communication as a proper public charge was slow in growth. Over the Cumberland road had been fought a great constitutional battle in the twenties. Subsequent national aid had been granted for improvement schemes through the several States involved. But in the Pacific railways Congress now dealt directly and immediately with the object before it.[2] The financial settlement with the Pacific railways is so recent that the land grants are still in politics, but in 1862 ten sections of land and a loan of $16,000 in United States bonds per mile of track did not tempt capital into the forlorn scheme. Construction could not be financed until the act of 1864 had doubled the ten sections into twenty and allowed the railway company to insert its own first mortgage, to the amount of the government subsidy, ahead of the federal bonds as a lien upon the property. With even this, responsible builders required so large a margin of profit that the construction of the road became a matter of noisome public scandal.[3] And in our own day a changed financial condition has made it difficult to understand the reasonableness of the original terms.

While the Union Pacific was under construction Congress provided the legal equipment for the annihilation of the entire frontier. The charter acts of the Northern Pacific, the Atlantic and Pacific, the Texas Pacific, and the Southern Pacific at once opened the way for some five new continental lines and closed the period of direct federal aid to railway construction. The Northern Pacific received its charter on the same day that the Union Pacific received its double subsidy in 1864. It was authorized to join the waters of Lake Superior and Puget Sound, and to receive for its services 20 sections of public land in the States through which it ran and 40 in the Territories. No bonds were granted it, the Union Pacific experiment remaining the first and the last in this direction.

In the summer of 1866 a third continental route was pro-

[1] F. J. Turner, in *American Historical Association Report*, 1893, p. 206.

[2] J. B. Sanborn, *Congressional Grants of Land in Aid of Railways*, in *University of Wisconsin Bulletins*, No. 30, is a comprehensive study of these grants. The Illinois Central grant of 1850, which started the policy of land grants for railways, is thoroughly treated by W. K. Ackerman, *Historical Sketch of the Illinois Central Railroad*, Chicago, 1890.

[3] The Contract and Finance Company, which operated for the Central Pacific, escaped public notice, but the Crédit Mobilier of the Union Pacific played a large part in the campaign of 1872. (J. B. Crawford, *Crédit Mobilier of America;* R. Hazard, *Crédit Mobilier of America*, Providence, 1881; J. F. Rhodes, *History of the United States*, VII, pp. 1–18.)

vided for in the South along the line of the thirty-fifth parallel survey. The Atlantic and Pacific was to build from Springfield, Mo., by way of Albuquerque, N. Mex., to the Pacific, and to connect near the eastern line of California with the Southern Pacific of California. Its subsidy of public lands was like that of the Northern Pacific.

The Texas Pacific was chartered March 3, 1871, as the last of the land-grant railroads. It was to build from the eastern border of Texas to San Diego, Cal., and was promised the usual grant of 20 or 40 sections. But since there were no public lands of the United States in Texas its eastern divisions received no aid from this source, while its more vigorous rival, the Southern Pacific, prevented its line from passing beyond El Paso. As usual, the Southern Pacific of California had been authorized to meet the new road near the Colorado River and had received a 20-section grant. It did better than its federal charter anticipated and organized subsidiary corporations in Arizona and New Mexico, which built rapidly and met the Texas Pacific at the Rio Grande.

To these deliberate acts in aid of the Pacific railways others in the form of local grants were made between 1862 and 1871, so that by the latter date all of the grants had been made, and all that the companies could ask for the future was lenient treatment. For the first time the Federal Government had taken an active initiative in providing for the destruction of a frontier. It resolved in 1871 to treat no longer with Indian tribes as independent nations, and used the Regular Army so vigorously that by 1880 "the majority of the wasteful and hostile occupants of millions of acres of valuable agricultural, pasture, and mineral lands [had] been forced upon reservations under the supervision of the Government . . . and the vast section over which the wild and irresponsible tribes once wandered [were] redeemed from idle waste to become a home for millions of progressive people." [1]

The new Pacific railroads began to build just as the Union Pacific was completed and opened to traffic. In competition with more promising enterprises in the East, they were slow in arousing popular interest. There was little belief in a continental business large enough to maintain four systems, and a

[1] G. W. Julian, "Our Land-Grant Railways in Congress," in *International Review*, XIV, pp. 198–212.

general confidence in the desert character of the semiarid plains. Their first period of construction ended abruptly in 1873, when panic brought most transportation projects to an inglorious end and forbade revival for at least five years.

Jay Cooke, whose Philadelphia house had done much to establish public credit during the war and had created a market of small buyers for investment securities on the strength of United States bonds, popularized the Northern Pacific in 1869 and 1870. Within two years he is said to have raised thirty millions for the construction of the road, making its building a financial possibility. And although he may have distorted the isotherm several degrees in order to picture his farming lands as semitropical in their luxuriance,[1] he established Duluth and Tacoma, gave St. Paul her opportunity, and had run the main line of track through Fargo, on the Red, to Bismarck, on the Missouri, more than 350 miles from Lake Superior, when his failure, in 1873, brought expansion to an end.

For the Northwest the construction of the Northern Pacific was of fundamental importance. The railway frontier of 1869 left Minnesota, Dakota, and much of Wisconsin beyond its reach. The potential grain fields of the Red River region were virgin forest, and on the main line of the new road, for 2,000 miles, no trace of settled habitation existed. From the summer of 1870 activity around the head of Lake Superior dates. The Lake Superior and Mississippi Railway was started to connect St. Paul and the lake at a point at which "a few papers signed in Philadelphia have made a great northwestern port and market possible—nay inevitable."

At Thompson's Junction on this road the Northern Pacific made a connection, securing its entrance into Duluth by buying a half interest in the tracks it used and building its own line west across the Mississippi River at Brainerd. The statute of 1864 made Lake Superior the eastern terminus, but the logic of trade brought to St. Paul in later years the terminus in fact.

The panic of 1873 caught the Northern Pacific at Bismarck, with nearly 300 unprofitable miles of track extending in advance of the railroad frontier. The Atlantic and Pacific and Texas and Pacific were less seriously overbuilt, but not less effectively

[1] Such a charge was made by Gen. W. B. Hazen, writing from Fort Buford, at the junction of the Missouri and Yellowstone, in the *North American Review* (CXX, p. 21), under the title "The great middle region of the United States and its limited space of arable land."

checked. The former, starting from Springfield, had constructed across southwestern Missouri to Vinita, in Indian Territory, where it arrived in the fall of 1871. It had meanwhile consolidated with the old Southwest Branch, of Missouri (recently renamed the South Pacific), so that from Springfield it could now get into St. Louis over its own tracks for most of the way. It had also, 1872, leased for a long term the Pacific of Missouri, with its dependencies. But the panic forced it into default, the lease was canceled, and the Atlantic and Pacific itself emerged from the receiver's hand as the St. Louis and San Francisco. Vinita was and remained its terminus for several years, and the completion of the road as a part of the Pacific system was in a different direction and under a still different control.

The Texas Pacific represented Texas corporations already existing when it received its land grant in 1871. It shortly consolidated local lines in northeast Texas, changed its name to Texas and Pacific, and began construction from Texarkana and Shreveport to Dallas and Fort Worth, on its road to El Paso. At the former points it caught its eastern termini, as did the Atlantic and Pacific at Springfield, Mo. The St. Louis, Iron Mountain and Southern ran from Texarkana to St. Louis, while from Shreveport, down the Red River to New Orleans, the New Orleans Pacific finally undertook the construction of the lines. This borderland of Texas, Missouri, and Arkansas thus became a center of railway development; in the grazing country behind it the meat-packing industries shortly found their sources of supply, and in our own day the State of Oklahoma is its concrete memorial.

The failure of Jay Cooke & Co. in the autumn of 1873 started the general financial panic of that year and deferred for several years the extinction of the frontier. It would have been remarkable had the waste and speculation of the civil war period and its enthusiasm for economic development escaped the retribution that economic law brings upon inflation. The Granger activities of the years immediately following the panic foreshadowed a period when the frontier demand for railways at any cost should give way to an agricultural insistence upon regulation of railways as the primary need. But as yet the frontier remained substantially intact, and until its railway system should be completed the Granger demand could not be translated into federal activity. For nearly six years after 1873 the

Pacific railways, like the other industrial establishments of the United States, remained nearly stationary.

In 1879 the United States emerged from the confusion of the

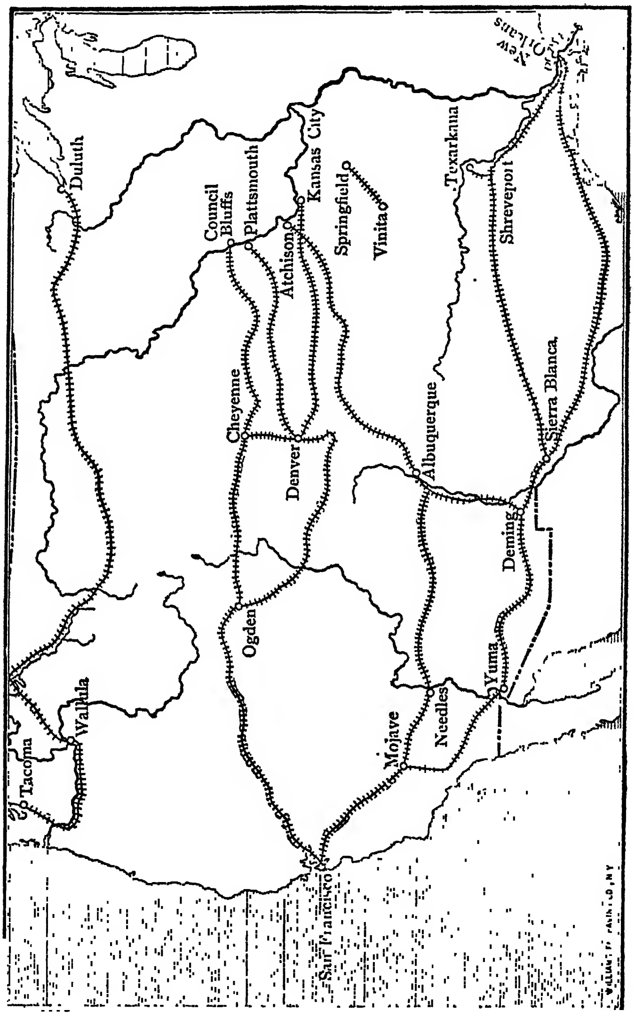


PLATE 3.—The Pacific Railroads

crisis of 1873. Resumption marked the readjustment of national currency, reconstruction was over, and the railways entered upon the last five years of the culminating period in the history of the frontier. When the five years had ended five new conti-

nental routes were available for transportation and the frontier had departed from the United States.

Although it had no continental franchise of its own, the Southern Pacific led in the completion of these new routes and acquired an interest in three eastern termini as a result. The Northern Pacific in the same years completed its own main line, while the Burlington-Rio Grande combination introduced at once a rival to the Union Pacific and an additional continental route.

The Texas and Pacific had only started its progress across Texas when checked by the panic in the vicinity of Dallas. When it revived it consolidated with the New Orleans Pacific to get its entry into New Orleans, and then proceeded to push its track across the State, aided by a state land grant from Texas, toward Sierra Blanca and El Paso. Beyond Texas it never built. Corporations of New Mexico, Arizona, and California, all bearing the same name of Southern Pacific, constructed the line across the Colorado River and along the Gila through the lands acquired by the Gadsden purchase in 1853.[1] Trains were running over its tracks to St. Louis by January, 1882, and to New Orleans in the following October. In the course of this Southern Pacific construction connection had been made with the Atchison, Topeka and Santa Fe at Deming, N. Mex., in March, 1881. But lack of harmony between the roads thus meeting seems to have minimized the importance of the through route thus formed.

The owners of the Southern Pacific opened an additional line through southern Texas in the beginning of 1883.[2] The Galveston, Harrisburg and San Antonio, of Texas, was the earliest road chartered in the State. Around this as a nucleus other lines were assembled, and double construction was begun from San Antonio west, and from El Paso, or more accurately Sierra Blanca, east. Between El Paso and Sierra Blanca, a distance of about 90 miles, this new line and the Texas Pacific used the same track. In later years the Texas Pacific was drawn away from the Southern Pacific by its St. Louis, Iron Mountain and

[1] The Southern Pacific seized the Fort Yuma crossing of the Colorado River in spite of federal and Texas and Pacific protests. . . . It later induced the Texas and Pacific to transfer to it the land grants west of El Paso pertaining to the latter road, and insisted before Congress upon its right to receive the lands although the grants were voidable, if not void, because of the failure of the Texas and Pacific to build within the time limit prescribed. . . . Congressional committees reported adversely to this claim of the Southern Pacific. . . . On February 25, 1885, Congress declared the whole Texas Pacific land grant forfeited. . . .

[2] Through trains to New Orleans were running by February 1.

Southern connection at Texarkana into the Missouri Pacific System, and the combination route through San Antonio and Houston became the main line of the Southern Pacific.

A third connection of the Southern Pacific across Texas was operated before the end of 1883, over its Mojave extension in California and the Atlantic and Pacific from the Needles to Albuquerque. The old Atlantic and Pacific, chartered with land grant in 1866, had built to Vinita by 1871, and had stopped there. It had defaulted after the panic, gone into receivership, and emerged as the St. Louis and San Francisco. But even after its emergence it refrained from construction much beyond its Vinita terminus. Meanwhile the Atchison, Topeka and Santa Fe had reached Albuquerque, N. Mex. This road, building up the Arkansas through Kansas, possessed a land grant as far as the Colorado state line. Entering Colorado, it had passed by Las Animas and thrown a branch along the old Santa Fe trail to Santa Fe and Albuquerque. At this last point it came to an agreement with the St. Louis and San Francisco by which the two roads should build jointly from Albuquerque, under the Atlantic and Pacific franchise, into California, and rapid construction had commenced in the period of revival. The Southern Pacific of California had not, however, relished a rival in its State, while the Atlantic and Pacific charter privilege extended to the Pacific. Long before the new road, advancing from Albuquerque, reached its Colorado crossing at the Needles a Mojave branch of the Southern Pacific was waiting at that point, ready by its presence to force the invading road to make terms with it for admittance. And thus upon the completion of the Colorado and Rio Grande bridges the Southern Pacific obtained its third entry into the East. Pullman cars were running into St. Louis on October 21, 1883.

The names of Billings and Villard are most closely connected with the renascence of the Northern Pacific. This line, with its generous land grant, had stopped before the panic at the Missouri River. In Oregon it had built a few miles into its new terminal city, Tacoma. The illumination of crisis times had served to discredit the route which Jay Cooke had so effectively boomed in earlier days. The existence of various land-grant railways in Washington and Oregon made its revival difficult to finance, since its various rivals could offer competition by both river and rail along the Columbia Valley below Walla Walla.

Under the presidency of Frederick Billings construction revived about 1879, from Mandan, opposite Bismarck, on the Missouri, and from Wallula, at the junction of the Columbia and Snake. From these points lines were pushed over the Pend d'Oreille and Missouri divisions towards the Continental Divide. Below Wallula the Columbia Valley traffic was shared by agreement with the Oregon Railway and Navigation Company, which, under the presidency of Henry Villard, owned the steamship and railway lines of Oregon. As the time for opening the through route approached the question of Columbia River competition increased in serious aspect. Villard solved the problem through the agency of his famous blind pool, which still stands remarkable in railway finance. With the proceeds of the pool he organized the Oregon and Transcontinental as a holding company, and purchased a controlling interest in each of the rival roads. With harmony of plan thus insured, he assumed the presidency of the Northern Pacific in 1881, in time to complete and celebrate the opening of its main line in 1883. He tried to give to this event a national aspect, but there were now four other through lines in operation, and a keen observer remarked that the "mere achievement of laying a continuous rail across the continent has long since been taken out of the realm of marvels, and the country can never feel again the thrill which the joining of the Central and Union Pacific lines gave it."

The land-grant railways completed these eastern connections across the frontier in the period of culmination. Private capital added another in the new route through Denver to Ogden, controlled by the Chicago, Burlington and Quincy and the Denver and Rio Grande. The Burlington, built along the old Republican River trail to Denver, had competed with the Union Pacific for the traffic of that point in June, 1882. West of Denver the narrow gauge of the Denver and Rio Grande had been advancing since 1870.

Gen. William J. Palmer and a group of Philadelphia capitalists had, in 1870, secured a Colorado charter for their Denver and Rio Grande. Started in 1871, it had reached its new settlement and health resort at Colorado Springs that autumn, and had continued south in later years. Like other roads, it had progressed slowly in panic years. In 1876 it had been met at Pueblo by the Atchison, Topeka and Santa Fe. From Pueblo it contested successfully with its rival for the grand canyon of

the Arkansas, and built up that valley, through the Gunnison country, and across the old Ute Reserve to Grand Junction. From the Utah state line it had been continued to Ogden by the Denver and Rio Grande Western, an allied corporation. A through service to Ogden, inaugurated in the summer of 1883, brought to the Union Pacific for the first time, and for its whole business, a competition which it tried to offset by hurrying its own branches from Ogden, the Utah Northern and the Oregon Short Line, north into the field of the Northern Pacific.

The continental frontier, upon which the first inroad had been made in 1869, was thus completely destroyed in 1884. Along six different lines between New Orleans and St. Paul it had been made possible to cross the sometime American desert to the Pacific States. No longer could any portion of the Republic be considered beyond the reach of colonization. Instead of a waste that forbade national unity and compelled a rudimentary civilization in its presence, a thousand plains stations beckoned for colonists and through lines bound the nation into an economic and political unit. That which General Sheridan had foreseen in 1882 was now a fact. He had written: "As the railroads overtook the successive lines of isolated frontier posts and settlements spread out over country no longer requiring military protection, the army vacated its temporary shelters and marched on into remote regions beyond, there to repeat and continue its pioneer work. In rear of the advancing line of troops the primitive 'dugouts' and cabins of the frontiersmen were steadily replaced by the tasteful houses, thrifty farms, neat villages, and busy towns of a people who knew how best to employ the vast resources of the great West. The civilization from the Atlantic is now reaching out toward that rapidly approaching it from the direction of the Pacific, the long intervening strip of territory, extending from the British possessions to Old Mexico, yearly growing narrower; finally the dividing lines will entirely disappear and the mingling settlements absorb the remnants of the once powerful Indian nations who, fifteen years ago, vainly attempted to forbid the destined progress of the age." Within two years after this utterance the frontier had finally disappeared, and with it had ended what Professor Turner has called "the first period of American history."

The significance of the frontier in American history has been considered at length in recent years. After 1885 the historical

problem is the significance of the disappearance of the frontier. In the change of epochs problems change as well. National organization replaces sectional; state activities tend to give way to federal; corporate organization succeeds individualistic; public regulation supersedes private initiative; and the imperative need for the creation of material equipment is transmuted into an equal necessity for the control of the activities to which the former need gave birth.

PART II

RAILROAD RATES

CHAPTER IV

REASONABLE RATES: VALUATION AND THE FAIR RATE OF RETURN[1]

I

The railways of the country have now secured a statutory rule of rate-making, which requires the Interstate Commerce Commission to fix such rates as will bring five and a half per cent (or at its discretion six per cent) upon the "fair value" of the aggregate railway property within a given district. Upon this clause the hopes of the financial community are centered. It is to bring stability and a certainty of return, to restore railway credit, to place rigid restraints upon a supposedly hostile regulating body. It is to substitute an inflexible rule for an uncertain administrative discretion.

Whether or not these hopes are well founded obviously depends upon whether the clause does contain a rule which may be applied with certainty and precision. Five and a half per cent is definite enough, but what is the "fair value" of the railroads? For the present it is obvious that the Commission can do little more than arbitrarily assign a value to the railway property in each rate district. But for the future "fair value" must be derived from the findings of the Commission in its gigantic task of valuing the railroads of the country under the Valuation Act of 1912 [1913—Ed.] How certain and stable a result does this valuation promise?

For better or for worse, we must now take it to be settled that under our American system of jurisprudence the problem is a constitutional one, and the Supreme Court the final arbiter. The Interstate Commerce Commission will before long complete its task of inventorying and appraising every item of railroad property in the United States. Field parties are making engineering surveys of every mile of track, appraisers are examining land values, accountants and experts are digging into historical records

[1] From Gerard C. Henderson, "Railway Valuation and the Courts," *Harvard Law Review*, vol. 33, pp. 902–928 (May, 1920). Reproduced by permission. See Jones, pp. 264–268, 275–307, and Vanderblue and Burgess, pp. 107–117, 335–352.

and corporate accounts. So far as a vast expenditure of money and indefatigable zeal can accomplish the task, the facts in the case are being brought to light.[1] As to findings of fact, it may be assumed that the conclusions of the commission will be deemed well-nigh conclusive, in actual practice if not in legal theory.[2] But these underlying facts constitute merely the raw material out of which the final decision must be made. The principles according to which the raw material is to be combined must be passed upon by the Supreme Court, and must square with the Supreme Court's conception of constitutional theory.

The object of this paper is to inquire into the premises upon which the court's function, as final court of review in valuation cases, must rest. I shall not attempt any detailed analysis of cases, nor any voluminous marshaling of economic data. The inquiry will lead, necessarily, into an analysis of the nature of the problem which will confront the court, and an examination of those decisions of the court which will throw light upon its own conception of the premises upon which it must act. The inquiry into the nature of the relation between the public utility and the community will lead to certain conclusions which seem to me to have a practical bearing upon some of the problems now agitating the legislature and the courts.

When railroad regulation first became a subject of political and legal controversy, the constitutional issue was simple. The railroads claimed that they were entirely exempt from rate regulation. They operated under charters granted by the states, which in so many words gave them the right to fix their own passenger and freight rates, and these charters were contracts, sacred from the touch of state legislatures. Their property was private, they were in private business operating for profit, and any state interference not specifically authorized in their charter violated those general guarantees in the Fourteenth Amendment, the sweeping character of which lawyers and courts were just beginning to appreciate. The claims on the other side were just as clear cut. The lawyers of the anti-railroad forces claimed that any regulation of rates, however drastic, was valid. The charter provisions giving the railroads power to fix rates meant no more than power to fix rates in accordance with, or in the absence of, state legislation. And apart from

[1] See Homer B. Vanderblue, *Railroad Valution by the Interstate Commerce Commission* (1920). Reprinted from the *Quarterly Journal of Economics*, vol. 34.
[2] *Cf. Van Dyke* v. *Geary*, 244 U. S. 39 (1916).

charters, the railroad business was a public business, resembling in many ways the businesses of trucking, ferrying, carriage driving, and the like, which the British Parliament had traditionally regulated. Regulation of railroad rates was therefore a proper legislative function and quite beyond the jurisdiction of the courts. No one ever heard of a British court inquiring whether a schedule of rates for wagoners or ferrymen, fixed by Parliament, was reasonable. If a legislature fixed unreasonable rates, the people had their remedy at the polls, not in the courts.

In the granger cases,[1] in 1876, a majority of the Supreme Court sustained to its full extent the popular view. It not only upheld the power of the legislature to fix rates, but it declared that the legislature alone was the judge of what was a reasonable rate. "The controlling fact is the power to regulate at all. If that exists, the right to establish the maximum of charge, as one of the means of regulation, is implied." If the rate has been improperly fixed, the legislature, not the courts, must be appealed to for the change. The argument that the charter protected the corporations against rate regulation was met by pointing to the general clause in state constitutions reserving the right in the legislature to alter all corporate charters.

One point in this early controversy it is important to understand. There is much discussion whether rate fixing is in its nature a "judicial" or a "legislative" function. This was a period in the history of American jurisprudence when discussions of this sort were popular. The separation of powers into executive, legislative, and judicial was looked upon as more than a mere differentiation of functions based upon practical considerations; it was thought to be the manifestation of an inherent truth. The pseudophilosophy of the period regarded certain governmental acts as in their nature judicial, and hence never to be exercised, under the constitution, by either the legislative or the executive branch. The opponents of legislative rate regulation tried to bring rate fixing into this category. At common law, in the absence of legislation, a public utility was bound to charge no more than a reasonable rate, and if a shipper or a passenger complained of an act of extortion, it was for the court to decide whether in fact the rate was unreasonable. In such a case reasonableness was a judicial question. So much the court in the granger cases readily admitted.

[1] *Munn* v. *Illinois*, 94 U. S. 113 (1876); *Chicago, B. & Q. R. Co.* v. *Iowa*, 94 U. S. 155 (1876); *Peik* v. *Chicago, etc., Ry. Co.*, 94 U. S. 164 (1876); and cases following.

But it declined to draw the conclusion that a rule of the common law, leaving to the courts the issue of reasonableness, could never be changed by the legislature. Chief Justice Waite pointed out that as soon as the legislature had changed this common-law rule by substituting a specific schedule of rates, reasonableness ceased to be an open question on which courts could pass. Potentially, rate regulation was a legislative question; it was merely by default of the legislature that the courts had anything to do with it.

If the matter had rested there, the constitutional history of rate regulation would have been brief. If a legislature had uncontrolled power over railroad rates, it could delegate this power to an administrative tribunal, and make the decision of that tribunal conclusive on all questions of reasonableness. The courts would have nothing to do with the matter. But the railroads represented immense property investments. The granger legislation aroused bitter political passions, and grave fears among those who believed that the welfare of the country depended upon the security of property. In case after case, as it came before the Supreme Court, the leaders of the bar appealed to the court not to leave the vast interests of private stockholders at the mercy of radical state legislatures. To have withstood this appeal would have been utterly inconsistent with the individualistic spirit which pervaded American jurisprudence in the latter part of the nineteenth century. Some method must be devised by which the courts could check the assaults of western legislatures upon established property rights. The court obviously could not go back on its decision in the granger cases, and hold that railroads were completely free from legislative interference. The principle was too firmly established in the precedents. The problem was to find some midway course which would preserve the power of regulation, but would put a reasonable check on the exercise of that power, when it attempted to cut too drastically into property values.

How the Supreme Court, in the series of cases culminating in *Smyth* v. *Ames*,[1] finally hit upon what seemed a solution of this problem, is a familiar story. When *Munn* v. *Illinois*[2] was before the court, the juristic development of the Fourteenth Amendment was still in its infancy. Only four years before, in the Slaughter House cases,[3] the court had seemed reluctant to extend its protection to other classes than to Negroes. To hold that a statute on a subject which was in its nature legislative, conferring power which the Brit-

[1] 169 U. S. 466 (1898). [2] 94 U. S. 113 (1876). [3] 16 Wall. (U. S.) 36 (1872).

ish Parliament had traditionally exercised, and in which the forms of due process were observed, was lacking in due process, would at that time have seemed a bold step for the court to take. Where the legislature had delegated its power to a commission, and made the decision of that commission final, there was at least a possible argument that the railroad was deprived of its traditional right to due process by judicial inquiry.[1] But where the legislature itself fixed fares directly, or where a commission fixed rates under a law which provided for a judicial review, there were obvious difficulties in holding that the state was acting without due process.

The argument which finally prevailed, rested on the analogy of the law of eminent domain. If the federal government were to take physical possession of a railroad, obviously it would be necessary under the Fifth Amendment to pay just compensation. If instead of taking possession it issued an order compelling the railroad to give the use of its property to the public free of charge, this would virtually be taking the property for public use without just compensation. If it allowed the railroad to receive compensation for its services, there would still be a question for the court whether the compensation was just. It required, perhaps, a slight wrench to make a doctrine which required the government to *pay* just compensation, serve the purpose of requiring the government to permit the railroads to collect just compensation from their patrons; but the matter was never very minutely inquired into. Another difficulty also had to be overcome. The cases that came up to the Supreme Court involved state laws, not federal laws. There is no clause in the Constitution expressly forbidding a state to take property for public use without just compensation. It was necessary to go a step further, and hold that to take property without making what the Supreme Court thought to be just compensation, was to take it without due process of law, and this even where the forms of due process were faithfully adhered to.

Through this difficult pathway the court had to find its way, and it is no wonder that its progress was slow and hesitating. It threw up a kind of *ballon d'essai* in 1886, in the form of a *dictum* that "under pretense of regulating fares and freights, the State cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of property for public use without just compensation, or

[1] *Chicago, etc., Ry.* v. *Minnesota, etc., Ry. Co.*, 134 U. S. 418 (1890).

without due process of law." [1] The following year it still expressed a doubt whether "it would under any circumstances have the power" to hold a state rate regulation void on the ground that it was confiscatory.[2] A year later the *ballon d'essai* of 1886 was again thrown out.[3] But in 1892 the court was still in doubt whether it could ever hold that a rate fixed by the state legislature was unreasonable.[4]

Before pursuing this germinating theory to its full bloom in *Smyth* v. *Ames*, it is instructive to notice that in its earlier period of growth it was not without a rival. One member of the court, Justice Harlan, made valiant efforts to swing the court over to another theory, which would accomplish the same general result of limiting without abrogating the regulating power of the state. Justice Harlan participated in his first rate case in 1882.[5] In that case he voted with the majority in holding that the rate law in question was constitutional. But he filed a concurring opinion in which he developed a constitutional theory which would put a clear limit on the regulating power. The railroad's charter, he said, gave the railroad directors the power to fix "such rates of toll . . . as they shall by their by-laws determine." In view of the common-law history of public callings this must mean, he pointed out, "such *reasonable* rates of toll." The corporation had, therefore, a charter right through its directors to fix reasonable rates; they had no charter right to fix more than reasonable ratés. A statute which merely regulated rates down to the level of reasonableness did not infringe their charter right, but a statute which reduced rates below the level of reasonableness was an infringement of charter rights which, under the principle of the Dartmouth College case, would be invalid under the contract clause of the Federal Constitution. And whether or not this charter right had been infringed was necessarily a judicial question, not a legislative one.

Here were two alternative theories, which seemed to achieve the result the court was groping for. Each left the power to regulate in existence, and each established, without any very violent stretch of legal reasoning, a means of judicial protection against abuse of the power. In *Stone* v. *Farmers' Loan and Trust Co.*,[6]

[1] *Stone* v. *Farmers' Loan and Trust Co.*, 116 U. S. 307, 331 (1886).
[2] *Dow* v. *Beidelman*, 125 U. S. 680, 691 (1888).
[3] *Georgia R. R. & Banking Corp.* v. *Smith*, 128 U. S. 174 (1888).
[4] *Budd* v. *New York*, 143 U. S. 517, 548 (1892).
[5] *Ruggles* v. *Illinois*, 108 U. S. 526 (1883).
[6] 116 U. S. 307 (1886).

in 1886, the two theories seemed to come into sharp conflict. This was the case in which Chief Justice Waite sent up his first *ballon d'essai* under the Fourteenth Amendment. The statute in question authorized the railroad commission to reduce rates "so as to allow a fair and just return on the value of such railroad." Under the eminent domain analogy this was precisely what the railroad was entitled to receive. Justice Harlan, however, dissented from the decision, pointing out that the statute might authorize a reduction below the level of reasonableness, so long as a fair return on the "value" was allowed. But there was no necessary conflict between the two theories. A slight modification of Justice Harlan's conception of reasonableness would bring them into harmony. In *Budd* v. *New York*,[1] in 1892, the rate regulation was sustained on the ground that "the records do not show that the rates fixed by the statute are unreasonable, *or* that property has been taken without due process of law." In the Texas rate cases of 1894,[2] a unanimous court held that the rates fixed by the state were unconstitutional. There is only one opinion, and it appears to go on both the contract theory of Justice Harlan and the property theory of Chief Justice Waite. In discussing a preliminary jurisdictional question, Justice Brewer points out that it is an open question for the court to consider whether "there is not implied in the grant of the right to construct and operate, the grant of a right to charge and collect such tolls as will enable the company to successfully operate the road and return some profit to those who have invested their money in the construction." And a little later he says:

> "If the state were to seek to acquire the title to these roads, under its power of eminent domain, is there any doubt that constitutional provisions would require the payment to the corporation of just compensation, that compensation being the value of the property as it stood in the markets of the world, and not as prescribed by an act of the legislature? Is it any less a departure from the obligations of justice to seek to take not the title but the use for the public benefit at less than its market value?" [3]

The final holding was that the state law was "unjust and unreasonable." Apparently the court was still holding open the opportunity of selecting either or both of the theories, as might prove expedient.

[1] 143 U. S. 517 (1892).
[2] *Reagan* v. *Farmers' Loan & Trust Co.*, 154 U. S. 362 (1894).
[3] *Ibid.*, 410.

One of the Texas rate cases involved not a state but a federal corporation.[1] Here the contract theory obviously broke down. But this of itself would not be an insuperable obstacle to the application of Justice Harlan's theory in a modified form. The federal charter gave the corporation the right to fix reasonable rates. It would have been simple to hold that this federal grant of power carried with it an implied limitation of the right of the state to reduce its rates below the point of reasonableness, just as the grant of a federal charter to carry on the banking business had been held to carry with it an implied limitation of the taxing power of the state.[2] The court delivered only a brief separate opinion in this case, however, which does not make it clear on what theory it was relying.

In these Texas cases we hear the last of Justice Harlan's theory of an inviolable charter right to collect reasonable rates. In *St. Louis & San Francisco Railway* v. *Gill,*[3] the discussion turned entirely on the Fourteenth Amendment, and in *Covington, etc., Turnpike Co.* v. *Sandford,*[4] and *Smyth* v. *Ames,*[5] Justice Harlan the originator of the contract theory, who ten years before had considered a statute unconstitutional which allowed only a "fair and just return on the value" of the railroad, himself delivered an opinion for a unanimous court, based squarely on the Fourteenth Amendment. A railroad corporation, he said, is a "person" under the Constitution, and a statute or regulation which does not allow just compensation for railroad services deprives it of property without due process of law. And "the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public."[6]

Is there any significance in the fact that the court, having the choice of two possible theories, each achieving virtually the same result, finally accepted the property theory and rejected the contract theory? Does it throw any light on the subsequent course of judicial decision? Since the court does not itself give any reasons for its choice, one can only speculate. But it seems to me that the choice has some significance.

[1] *Reagan* v. *Mercantile Trust Co.*, 154 U. S. 413 (1894).
[2] *McCullough* v. *Maryland*, 4 Wheat. (U. S.) 316 (1819).
[3] 156 U. S. 649 (1895).
[4] 164 U. S. 578 (1896).
[5] 169 U. S. 466 (1898).
[6] *Ibid.*, 546.

For a court composed of nine jurists, appointed for life, to annul a legislative expression of the popular will is always a delicate matter. To upset a law which has behind it the political passions and aspirations of a great popular movement like the granger movement of the seventies, requires particular circumspection. Above all, the judges must have been anxious to avoid the suspicion that they were substituting their own discretion for the will of the legislature. Their decision must rest on judicial, not on legislative grounds. A court acting judicially ascertains facts, and applies to them rules derived by certain processes of reasoning from established principles or precedents. A public body with legislative powers ascertains facts, perhaps, but it applies to these facts its own sense of what is in the public interest. Now the word "reasonable" carries with it a large suggestion of legislative discretion. No process of juristic reasoning can point with certainty to the precise limit beyond which a rate ceases to be reasonable. For twenty years the court had been saying that the issue of reasonableness was a legislative and not a judicial question. But a decision based on the rule in *Smyth* v. *Ames* would have at least the illusion of juristic necessity. What the value of a railroad was, seemed on the surface to be a pure question of fact, and a fair return could easily be ascertained by reference to current rates of profit. A judge who upset a state statute on the ground that it failed to allow a reasonable return on the fair value of the property seemed protected against any charge of usurping legislative power. He need only point to the ascertained facts, and shift all responsibility to the framers of the Constitution.

Certainly the language of the cases subsequent to *Smyth* v. *Ames* in the main bears out the hypothesis that the court has been trying to ascertain not a rule of policy, but a discoverable fact. The question has been, not what is it wise to allow the company to earn, but what is the value of the property on which it must be allowed to earn a return. In *Smyth* v. *Ames* the court enumerated seven factors which were to be taken into account "in order to ascertain that value,"—cost of construction, cost of improvements, amount, and market value of stocks and bonds, present cost, probable earning capacity, and operating costs. It suggested that there might be other factors. But these were merely different kinds of evidence, to be given such weight as they deserved. They were like the instructions of the court to a jury in eminent domain proceedings. The court instructs the jury that they must find,

as an ultimate fact, the market value of the property in question. Perhaps it will enumerate the different kinds of evidence submitted at the trial, bearing on this ultimate question. The evidence may be contradictory, and the methods of valuation of the expert witnesses may have been inconsistent. But it is for the jury to give to each item of evidence such weight as in their judgment it deserves. The only requirement is that their ultimate finding must be a finding of fact. They must make up their minds what the property is worth, not what they think the owner should in fairness receive for it. No other explanation of the Supreme Court's enumeration of inconsistent and contradictory factors in *Smyth* v. *Ames* seems to me possible. The court was addressing the masters in chancery and the lower federal courts, and instructing them what ultimate fact they had to find, and what evidence they could consider.

On the whole, although there have been some suggestions that a rate schedule must be "just both to the company and to the public," [1] this conception that rates should be based upon an ultimate fact to be determined by inquiry has persisted. "What the company is entitled to demand . . . is a fair return upon the reasonable value of the property at the time it is being used for the public." [2] The price paid at a recent foreclosure sale is "evidence" of value.[3] The cost of reproduction is "one way of ascertaining the present value" of a public service corporation.[4] The cost of reproduction is "of service in ascertaining the present value of the plant," but it is not conclusive.[5] That mere conjecture is insufficient to justify overturning state legislation "is true of asserted value as of other facts." [6] This conception that there is a fact which can be discovered, if we are only persistent enough in our search for it, and which, once it is found, will provide a mathematical solution of all rate-making problems, is widely prevalent outside the Supreme Court decisions. Congress has instructed the Interstate Commerce Commission to "investigate, ascertain and report" the value of all property owned or used by common carriers. It is the general practice of many state public service commissions to conclude their opinions with "findings

[1] *San Diego Land Co.* v. *National City*, 174 U. S. 739, 758 (1899).
[2] *Ibid.*, 757.
[3] *San Diego Land & Town Co.* v. *Jasper*, 189 U. S. 439, 443 (1903).
[4] *Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1 (1909).
[5] *Minnesota Rate Cases*, 230 U. S. 352 (1913).
[6] *San Diego Land & Town Co.* v. *Jasper*, 189 U. S. 439 (1903).

of fact" as to the value of the utility in question. Indeed a general technique seems to have been developed, among state commissions, the object of which appears to be to render their decisions proof against reversal in the courts. The commission inquires minutely into the several "evidences" of value enumerated in *Smyth* v. *Ames:* original cost, cost of reproduction, capitalization, value of stocks and bonds, etc. It then marshals the figures, of course widely divergent, which these different lines of inquiry produce, and concludes somewhat as follows: We have considered carefully the facts which the Supreme Court has directed us to consider, and have given to each fact such weight as in our judgment it deserves. We therefore find that the value of the property is so and so. The final figure involved generally bears no arithmetical relation to any of the evidentiary figures which the commission has "taken into consideration" and no indication is given to the logical process by which the figure is reached.[1] A court which is reviewing such a decision obviously finds it exceedingly difficult to hold that a wrong method was applied in valuing the property, since it is not clear what method, if any, was in the commission's mind. Unless the net result is clearly unjust, the court is more than likely to treat the whole question as one of fact, on which the decision of a fair-minded board which considers all the evidence is virtually conclusive.[2]

II

Smyth v. *Ames* closed the first great chapter in the judicial history of rate regulation in the United States. The conflicting desires which plagued the Supreme Court in the granger and railroad commission cases were reconciled by the unanimous adoption of a formula which conceded what the majority of the court desired, the power to regulate, and yet guarded against what the minority feared, confiscation. The second chapter was already opening. What content should be given to the general terms of the formula? The formula implied a business relation between the railroad and the public. A certain service was to be performed and a certain measure of compensation to be paid. But what were the detailed

[1] See, for instance, *Re Champaign & Urbana Water Co.* (Ill. Pub. U. Com'n), P. U. R. 1919 E, 798, 825; *Harbster* v. *Angelica Water & Ice Co.* (Penn. Pub. S. Com'n), P. U. R. 1918 E, 540, 548; *Re Western Col. Power Co.* (Colorado P. U. C.), P. U. R. 1918 E, 629, 648; *Pub. Serv. Com'n* v. *Pac. Tel. & Tel. Co.* (Washington P. S. C.), P. U. R. 1916 D, 947, 959; *Re Valuation Missouri Southern R. Co.* (Mo. P. S. C.), P. U. R. 1916 C, 607, 648.

[2] As in *Van Dyke* v. *Geary*, 244 U. S. 39 (1916).

terms of this hypothetical agreement? What risks was each side to assume? What meaning should be ascribed to the word "value," and what was a "reasonable return"? To any one familiar with the intricacy and refinement of detail in any business contract involving large sums and complex relations it must be apparent that the general language of the rule in *Smyth* v. *Ames* could only be regarded as a preliminary formulation, and that the task of giving it precision of meaning and fullness of detail still lay in the future.

The answer to these questions is obviously not to be found in *Smyth* v. *Ames* itself. Sometimes a court uses a word to which it ascribes a clear and definite meaning, but which to the reader is ambiguous. In such a case a minute inquiry into the context, the facts of the case, the precedents and the theoretical probabilities, may reveal just what it was that the court meant. But a mere grammatical inquiry of this sort is of little use in interpreting the rule in *Smyth* v. *Ames*, for the ambiguity of the words "fair value" is of a different sort. It is more probable that the court did not have in its mind any clear definition of the phrase. Consciously or unconsciously, it used words which merely described a large area of possible meanings. The use of such words of indeterminate meaning is not uncommon in jurisprudence, and almost universal in political discussion. Whether or not the court was originally aware of the ambiguity is of no importance. It must sooner or later have realized it, and intentionally left it to the future to decide what signification the term should have.

Before inquiring in what manner and to what extent the Supreme Court has accomplished this task, it will be helpful to consider more carefully the elements involved in the business relation which the rule of *Smyth* v. *Ames* covered. Juristically, the problem may be to construe and interpret certain general concepts, such as property, due process of law, just compensation, but mere analysis of juristic concepts will not carry us very far. For the moment let us forget the Fourteenth Amendment and the nature of property. Instead of deducing a rule of rate making from a definition of value, or from a theory of the police power or of the nature of judicial and legislative functions, let us consider the matter pragmatically, as a problem in practical statesmanship.

The community requires certain transportation services. It is willing to pay for them, but for practical reasons, or perhaps because of certain historical and political preconceptions, it does not wish to undertake the construction and operation of the neces-

sary facilities through its own governmental agencies. A group of citizens with financial resources form a company and offer to perform the services for the community, provided a satisfactory agreement can be reached as to the terms on which the services shall be performed and paid for. The agreement is obviously one of the very greatest importance, both in the magnitude of the financial interests involved, and in the vital effect which it will have on the business development, the health, and the prosperity of the community. One might naturally expect that the leading principles of such an agreement would be debated with the greatest thoroughness, and that they would be embodied in a written instrument in which the reciprocal rights and obligations of the respective parties were set down with the utmost clarity and refinement of detail.

Let us visualize the negotiations which might lead up to such an agreement. A committee representing the community is closeted with a committee representing the company. We will assume that a certain consensus of opinion has already been achieved. The committee for the public has rejected the company's proposal that the government should give a financial guarantee of operating expenses and a fair profit. The company has rejected the counter proposal that a fixed schedule of rates be embodied in the contract, the company taking the risk of increases in operating expenses and of fluctuations in the volume of traffic. It is agreed that the company shall look for its compensation to the fares and freight charges, and not to the public treasury, and that the level of rates shall be under the control of a regulating tribunal, and shall vary with the larger fluctuations in costs of operation. "We are not now asking for a guarantee," the president of the company points out. "If business is so poor and expenses are so high that the traffic will not bear rates high enough to earn a profit, we are willing to stand the loss. If business is good, and expenses low, we are willing to let you cut down our rates to a fair profit. All we ask is that if our profits are too low, and if higher rates can increase them, you will let us raise our rates."

The proposal seems a sensible one, and the committee for the public withdraws for a few minutes for discussion. A lawyer among them, and also an economist, are seen to speak earnestly to the chairman, and as soon as the conference is resumed, the latter takes up the conversation.

"Of course you did not mean," he begins, addressing the com-

pany delegates, "that we should let you at all times charge rates high enough to give you a profit, regardless of the efficiency or lack of efficiency of your business. If you see fit to employ an incompetent general manager, of course you do not expect our constituents, your customers, to bear the burden of his incompetency. We have every confidence in the integrity of you gentlemen, but your successors may be of a different stripe. Suppose they should make a grievous mistake, and order a lot of engines of a type poorly adapted to your road, so that your trainload would have to be cut down and your speed reduced? Or suppose even that they should organize a car construction company, and buy freight cars from it at exorbitant prices? You catch our point. Doubtless you will not object to our putting into the agreement the qualifying words, 'so long as the property is operated honestly, progressively and with the highest efficiency and technical ability.'"

The representatives of the company of course agree in principle, although the company's attorney suggests substitution of the word "reasonable" for the words "the highest." After all, the community cannot expect them to employ the very highest talent in the country, regardless of cost. But they point out that the qualification suggested by the public representatives introduces into the agreement a most undesirable element of uncertainty. Who is to decide what is reasonable efficiency? Surely that is a matter on which men of equal ability and experience can differ widely. Suppose there is a disagreement between the company and the community? Who is there that has the infinite wisdom, the universal experience, and the supreme impartiality to render a true decision? The public representatives admit the difficulty, but ask that it be postponed for the time being, while they pass on to the second point.

"There may be," the chairman continues, "some unforeseen development, which cannot be guarded against, which seriously depletes your earnings. Suppose, for instance, a great public catastrophe, a fire, an earthquake, a flood, which not only interrupts traffic, so that your income is lessened, but greatly increases your operating expenses. Or suppose there is a prolonged strike. Do you expect us after such an extraordinary event to increase your rates until you have recouped the loss? Or imagine a loss due to a mistake in judgment, which is not so reprehensible as to amount to negligence. Who is to stand that loss?"

"That, of course," says the company's president, "would be an

ordinary expense of operation. You can expect us to be reasonably efficient, but you cannot expect omniscience. You cannot expect our foresight to be as wise as your hindsight. As long as we behave like ordinary reasonable business men, we are entitled to our fair profits."

"But are you not overlooking the fact that every business man assumes the ordinary risks of his business?" interposes the economist in the public delegation. "If you were investing in a clothing factory, you would stand the risk of fire, earthquake, and flood. Direct fire loss, perhaps, we might be willing to let you insure against, and we would not object to your charging the premium to operating expenses. But the risks of business disturbance, of strikes, of unavoidable mistakes of judgment, fall on every business man, and we see no reason why they should not fall on you."

The company negotiators point out that their business will be different from an ordinary private undertaking, and their attorney says that Lord Hale once described such a business as "affected with a public interest." A long discussion ensues, and it is finally agreed to postpone settlement of this point till the question of profits is reached. For the company representatives insist that if they are to assume any risks other than those arising out of their own negligence, they should be amply paid for it.

The discussion shifts to the question of what profit is to be allowed, and many divergent views are expressed. The company representatives first suggest a percentage of expenses, but the proposal proves unacceptable for obvious reasons. The public negotiators suggest a lump sum annually, to be specified in the contract, but it is pointed out that in the course of many years business may increase enormously, and it may be necessary to sink larger amounts of capital and assume larger risks, so that a lump sum which is adequate to-day may prove inadequate ten years hence.

The company's attorney then suggests that it be allowed always a certain percentage on the value of the property. If value goes up, rates should go up proportionately. But the economist points out that the only accepted and sensible meaning of the word "value" is "value in exchange,"—the amount which the property would bring at a free sale, and that obviously this depended mainly on earnings. "But earnings," he said, "will depend partly on what we allow you gentlemen to charge the public. If we reduce your

rates, your value goes down. If we increase them, it goes up. Obviously we cannot measure rates by value, if value is itself a function of rates."

Finally, some one suggests that rates be fixed so as to bring as nearly as possible a fair return on the amount of money actually invested in the undertaking. If the business expands and more capital is sunk, the return will automatically increase. If some of it proves unprofitable and is abandoned, the return would automatically decrease. The chairman of the public group points out that of course such an arrangement would be subject to the qualification, already accepted as to operating expenses, that the investment on which a return is sought was honestly and efficiently made. The company negotiators agree in principle, although they point out again the large element of uncertainty which such a qualification involves. It is also agreed that the question of responsibility for reasonable mistakes of judgment in capital construction must be held in suspense until the rate of return is discussed. But the company representatives raise some more fundamental questions.

"The railroad," says one of their number, a banker, "will run into a region which is as yet undeveloped, but which I confidently believe has brilliant prospects. There is a city, for instance, in which we expect to build large terminals, and buy extensive real estate for roadbed and freight houses and passenger stations. The land will not cost us much to-day, but if my judgment as a business man is vindicated, it will some day be worth five or ten times what it costs to-day. Now we are taking the risk of the community languishing and failing to supply enough traffic to make the road profitable. Are we not entitled to a share in the general prosperity of the country? If our real estate investment appreciates, are we not entitled to reap the rewards of our business acumen in selecting the site? Every other business gets such a reward if it is wise in its real estate purchases, so why should not we?"

"That is true also of our investment in work and materials," says another of the company representatives, an engineer. "It so happens that this year, as you all know, is a year of great business depression. There is little free capital for investment or expenditure, and business is stagnant. Owing to the unusual resources and conservative financial policies of the gentlemen who compose our group, we have been able to raise the necessary capital now, to take advantage of the period of depression. Soon prices will

take an upward turn. Those of you who have studied curves of business cycles will agree that that must be so. Are we not to get a return on the greater value which will inhere in our plant when the general level of prices has gone up? Are we to be penalized because our foresight and resources enabled us to have capital available while prices were low, instead of waiting till they were high?"

"Take another aspect of the situation," resumes the banker. "In my home town, through which the proposed railroad will run, the citizens were so anxious that their town should be included in the line that they offered, through the town authorities, to give several acres available for terminal facilities and roadway, free of charge. Now of course that property is worth something. The fact that they are donating it does not take away a cent of its value. The gift is a purely private arrangement between the town and the railroad, in which you gentlemen are not at all concerned. The community will get just as good service whether we pay for the land or not. It does not seem right that you should take away from us the gift which the city has for reasons of its own seen fit to bestow on us. Yet that is exactly what your theory of allowing us a percentage on our actual investment would do."

"There is another point," the president adds. "You speak of the actual cost of the business—the cash investment which we will have made. Are you forgetting that we are investing more than mere cash? The plant will be worth more than the mere dollars and cents put into the individual items of real estate and rolling stock and improvements. We are investing not only our cash, but our reputation, our business experience, our energy and initiative. We will give you a living, working organism, not merely the bare bones, the *disjecta membra,* of land and steel and wood. Moreover the members of our group have a reputation in the community, and, I may add, a certain popularity, which will strongly influence the public toward patronizing our line. And does not the fact that the public has entrusted us with this vastly important public undertaking (assuming that these negotiations are successful), and given us a valuable franchise from which all others are excluded, does not that fact of itself add to the value of our property? Every business man knows that these intangible elements—the value of our plant as a going concern, the value of its good will, and the value of its franchise—are among the most important possessions of a company such as ours."

The chairman of the public negotiators is somewhat taken aback by these arguments. In private life he is a department-store proprietor, and his income has kept pace with the growth and prosperity of the city. But the lawyer comes to the rescue.

"That would be all very well, gentlemen," he says, "if you were going into a purely private business. But as my brother on the other side has so well said, transportation is affected with a public interest. It is in its nature, if I may use the word, a governmental function. If the government cared to, it could go into the business itself, and operate the railroad as a public service, without any profit above the interest on its bonds. Moreover it is in a sense a monopolistic business. To acquire the right of way for your roadbed, you will need to exercise the right of eminent domain, a right which we can give or withhold at pleasure. Before a competitor can cut into your field, he must get a franchise from us, and although we cannot of course guarantee you a perpetual monopoly, yet we know that competition is a dangerous and disturbing element in railroading, so that as a practical matter we are likely to leave you in possession of the field."

"Moreover," interposes the economist, "a railroad requires an unusual amount of fixed investment before it can be put into operation, and hence there must be a promise of a large amount of business before capitalists will venture to enter a field in which a company is already installed. So that there is an unusual degree of what I may call natural monopoly, quite apart from any legal restrictions which may exist."

"What is the conclusion to be drawn from the fact that your undertaking is a quasi-public one, and that it is semi-monopolistic?" continues the lawyer. "Is it not precisely that you are to be treated differently from men who engage in an ordinary competitive venture? That you are not to be allowed to charge what the traffic will bear? You are asking us for a franchise. If we give it to you, it will be in order that you may serve the public at reasonable rates, not so that you can make an undue profit out of the public. You are given a right of eminent domain, with which you are able to acquire land at reasonable prices. That right is a sovereign right, which exists under the constitution only for public purposes. We would be betraying our trust if we were to let you forcibly appropriate another's land by the exercise of a governmental right, thus depriving him of the possibility of enhancement of value, and then convert that land into a source of private enrichment.

What you paid for the land, provided it was reasonable, was a legitimate investment, on which you are entitled to a return, but any increment belongs to the public. Or take the land which you expect to receive from the city authorities. Can we assume that the city is giving you that land to swell your own private incomes? Surely the object of its benevolence is the public. A city would be acting beyond the scope of its municipal powers if it gave away municipal property for the private benefit of a few individuals. We must assume that it gave you the land, so to speak, in trust for the public, and that the public is to get the benefit in the shape of lower rates."

"Besides," adds the economist, "how are you going to measure these intangible rights you speak of? Your good will, your franchise, your status as a going concern, have no value, in any accepted sense of the word, except as they contribute to your earning power. As a congeries of wood and iron, without a franchise to operate and collect fares, and without customers, your plant is mere junk. Earning power gives it value. But earning power, as I succeeded in convincing you this morning, is entirely dependent on rates. Your intangible rights are worth just as much, and just as little, as we decide to make them.

"Another point occurs to me," he continues. "You are asking that the amount on which a percentage of profit is to be earned shall include certain elements which we economists call unearned increment. This year your land may be worth a million. Ten years from now it may be worth two millions. You claim this year a rate sufficient to give you a return on the million, and ten years from now a rate sufficient to give you a return on the two millions. But if your property has been appreciating at the rate of a hundred thousand a year, why is not that hundred thousand dollars to be treated as a part of your income, just as much as the fares and freight charges paid by the public? Is it not income reinvested in plant? Income is that which induces the capitalist to sink his capital. When capital is sunk in land, the inducement is not merely the annual cash earnings, but the probable annual appreciation. My friend here (turning to the banker) can doubtless tell of many cases in which money has been sunk in real estate without any prospect of cash return in the near future, merely because the value of the land was expected to go up."

The discussion waxes warm. The company attorney disputes the contention of the lawyer for the public, and asks if capital

devoted to railroading is not just as much private property as capital invested in a department store, so long as its public obligations are fulfilled. "Is there any reason," he asks, turning to the economist, "why property should be confiscated merely because its value is hard to ascertain?" The engineer suggests that the value could always be ascertained by estimating the cost of reproducing the plant, new, at a given time, and making a reasonable allowance for depreciation. The intangible elements, he says, could be ascertained by assuming a phantom plant, ready for operation without any customers or good will, and estimating the cost in advertising, loss of profits, etc., of building up the business. To which the reply is made that in fact a business is never reproduced in this way, as a single unit, that the plant is built or improved and extensions are made when the labor and material markets are favorable, and that good will is built up gradually by judicious soliciting, by publicity, by the self-advertisement which springs from the mere fact of successful operation. And the expense of this acquisition of patronage will generally be charged to the operating account, and so will already have been paid for by the public. Finally the chairman of the public delegation, who has for a while allowed the others to carry on the debate, gets up from his chair and asks for attention.

"Gentlemen," he says, "I have listened with great interest to the discussion, and especially to what my good friends the lawyers on both sides have been saying. Some of it, especially that about Lord Hale, I confess I did not quite catch. Sometimes my friend the economist, here, got beyond my depth. But I think we can all of us understand the main points about which we've got to agree. My lawyer friend here has given us a theory which would decide all the disputed points in our favor. My lawyer friend on your side has given a theory which would decide them all in your favor. But, gentlemen, we are practical men. We have a practical business proposition to settle. Let's look at it in a practical way. We want a road built. We could build it ourselves, but we don't want to if we can help it. We could get some other group of gentlemen to do it for us, but we think we can make a reasonable arrangement with you. You gentlemen, on the other hand, have capital, and business ability, and a willingness to run some risks. You might invest your money and brains in some other line of business—in manufacture, or construction, or mining, or shipping. But you are ready to come to a reasonable agreement with us.

"First let us see just where we stand. We are agreed that you are to be allowed to charge a freight rate which (assuming there is enough traffic) will permit you to pay your operating expenses (provided you are operating honestly and efficiently) and a return on so much of your investment as was honestly and efficiently made. We haven't yet agreed whether you or the public are to take the risk of loss from extraordinary events, such as earthquakes and floods and strikes, or of unavoidable mistakes in judgment. We are at odds on the question whether you are to get the benefit of increased land values, or of appreciation in your plant due to higher prices and labor costs. We disagree as to the amount which is to be added, if anything, on account of franchise value, good will, or the value of your road as a going concern. On the other hand we haven't discussed at all the most important question of all, the percentage of return you are to get each year once the value is determined.

"I think, gentlemen, that we understand each other. I believe that the time has come for a reasonable compromise, and that if we bear in mind the welfare of the community, for which we are all working, we can settle the matter this afternoon. There is only one thought I would like to leave with you. The items on which we are still in dispute are interdependent. One hangs on the other. If you are to assume the risks of earthquakes, floods, and strikes, or of unavoidable mistakes in construction or operation, you will insist, and rightly insist, on a larger percentage return to compensate you for that risk. If we assume those risks, we are entitled to ask you to be content with a lower rate of return. If you are to get the benefit of what my friend calls the unearned increment, that is an added attraction which the community is offering you, and which should induce you to accept a very moderate rate of annual return; if you are to get a return only on the money actually invested, you will be reasonable in demanding a larger rate of return. Your business experience and foresight and reputation must no doubt be compensated, either by taking your services into consideration in fixing the rate of return, or by agreeing on some reasonable sum as the capital value of those services, and including it in the valuation. Those, I think, are the elements out of which our agreement must be made. Let's forget Lord Hale, and get together on a sensible basis."

Anyone familiar with business negotiations can imagine what the outcome will be. There will be give and take. Each side will

concede something. One point will go in favor of the government, another in favor of the company, without much regard either to legal principle or economic theory. Just where the compromise will be, must depend on a number of strategic factors—on the strength of the capitalists' desire to undertake the enterprise, and of the government's desire to have them do it, on their relative bargaining powers, perhaps on the toss of a penny. What is yielded in valuation may be reclaimed in rate of return. Perhaps the public representatives will be strong enough to gain almost all their points; perhaps they will be weak enough to concede almost all. Somewhere a compromise will be hit upon. Then the lawyers will get together and draw up the results of the negotiation in a document which expresses in legally effective language the practical compromise which has been reached.

III

My object in rehearsing this imaginary negotiation has been to bring out the true character of the hypothetical contract which the rule in *Smyth* v. *Ames* implies. Many business transactions are entered into without a clear formulation of terms. A man visits a doctor; he does not generally settle in advance the fee which he is to pay. A woman buys two pounds of sugar at a grocery store; she may not know till the end of the month what the price is. Where there is a simple transaction like the sale of a commodity with a current price, or performance of services which have a customary value, it is not impossible for a court to arrive, *ex post facto* with reasonable certainty, at the probable terms of the contract. Even if there is no standard by which the terms could be gauged, such as a market price, or a customary fee, there are currently accepted rules of reasonable conduct which make it possible for a court to reconstruct fair terms without doing substantial injustice to either party. But where the contract is virtually unique, where there is no accepted standard of reasonableness to which its terms can be referred, and where the relations which it determines are from their nature complex beyond measure, a court which attempts to deduce from general notions of reasonableness and customary fairness the unwritten and unthought terms of such a contract, made perhaps fifty years ago, is obviously attempting the impossible.

In no class of business agreements is the utter impossibility of attempting to reconstruct *a posteriori* the probable terms of a non-

existent contract more apparent than in the case of agreements involving an element of extraneous risk. An insurance contract is a typical example. The insured is to pay a certain premium, and the insurer is to pay a certain principal sum if certain contingencies happen. If the court knows neither the premium which is to be paid, nor the contingencies upon which payment of principal depends, obviously it cannot reconstruct the contract along general lines of reasonableness, or by guessing at what the parties probably meant. The premium might have been large, and the contingencies probable, or the premiums small and the contingencies remote. Either alternative would have been equally reasonable, and equally probable.

The relation between the owners of a public utility and the government is not a standardized relation. There is no generally accepted norm to which a contract embodying such a relation can be assumed to conform. It is not a simple transaction, like the sale of a current commodity, or the performance of customary services. And it involves to a large degree the element of extraneous risk. The probable earnings depend upon a number of contingent factors, some within the control of the owners, some within the control of the government, others beyond the control of either. The risk of loss or chance of profit from any one of these contingencies, and especially from those which are beyond the control of either party, may fall on the company or on the community, and in many cases it is impossible to say whether it should more reasonably fall on one or on the other. It all depends upon who pays or receives the theoretical insurance premium against the happening of these contingencies.

I have already indicated, in the imaginary negotiations which I have portrayed, some of the uncertain factors in the public utility relation. What standard of reasonableness or what law of probability can determine whether the company or the public shall stand the risk of unforeseeable catastrophies or of reasonable mistakes of judgment? Or which side to the bargain shall get the benefit of unearned increments of value, or of the cheaper unit costs of operation and larger gross revenues due to the growth of the community? There are at least two other elements of uncertainty, of the most far-reaching importance.

Obviously there is no mathematical relation between earnings and rates, although courts and commissions sometimes speak as if there were. The level of rates is only one of the three major factors

which affect earnings. The other two are the level of expenses, and the volume and character of traffic. A regulating commission may fix a schedule of rates designed to produce say a seven per cent return on a given valuation. But there may be a slump in traffic, or a temporary rise in operating expenses, which cuts down the actual return to five or four per cent. What disposition is to be made of this "deficit"? Or the deficiency may arise in the early development years of the company's life, before traffic has reached its full volume, and before the machine is working smoothly. Is the company to be reimbursed for such deficiencies, or are they among the risks which it assumes? If it is to be reimbursed, in what manner? Obviously there are many possibilities. A distinction might reasonably be made between differences due to miscalculations of the commission as to probable operating expenses, and deficiencies due to insufficient traffic. To begin with the first. Shall the commission each year, in fixing rates for the ensuing year, take into account its own under- or over-estimate of expenses the previous year, and correct the award for the ensuing year by adding or subtracting the amount of the previous miscalculation? Theoretically such a procedure would perhaps be correct; but it is equally probable that in view of the almost insuperable difficulty of determining how much of the deficit or surplus was attributable to the miscalculation, and how much to other causes, the government would insist that its good faith and fairness be taken for granted, and that the company be satisfied with the regulating body's general duty to act fairly and to the best of its ability. Deficits due to lack of traffic offer even greater difficulties. It may be assumed that the government has not under any circumstances agreed to make good losses out of its own treasury. But suppose that during the early years of development traffic was light, but that in later years it has grown to remunerative proportions. Is the company entitled to recoup its early losses out of subsequent earnings? If so, in what manner? By calling the early loss a capital investment, part of the cost of production of the business as a going concern, and hence part of the fair value on which future annual returns are calculated? Or by recouping the losses as rapidly as the traffic will bear? Or by amortizing them over a period of years? Or shall the early losses be deemed one of the business risks which the company has assumed, and for which the annual return is deemed a fair compensation? Obviously any one of these alternatives might reasonably have been agreed upon.

A similar problem arises when a company for some time in exclusive possession of the field is suddenly subjected to competition, and its earnings materially reduced. If after a few years the competitor is eliminated or bought out, or if traffic develops in sufficient volume to make both railroads profitable, are the competitive losses to be recouped, or are they, too, among the risks assumed by the company?

The second element of uncertainty arises out of the rate-making practices of the railroads. It is a well-known fact that under a commercial system of rate making certain commodities are carried at a rate so low that while perhaps they bring in their out-of-pocket expenses, they add little if anything to the continuing costs of operation or to the fixed charges or dividends. The state of the law appears to be that while a railroad may of its own volition reduce rates to such a level, for reasons of commercial competition, without incurring the charge of unjust discrimination, nevertheless the government cannot constitutionally force a railroad to make such special rate reductions, even if the net result of all its operations is to bring in a fair return.[1] Assume that a railroad has made such competitive reductions on a substantial number of commodities. Has it a constitutional right to recoup the deficiency in net earnings from these commodities out of such of the traffic as will bear a higher rate? Or are the losses from its competitive ventures for its own account?

Thus it is apparent that were we privileged to transport ourselves back to the days in which railroads were built, even if we could carry with us all the economic and juristic wisdom which the last quarter-century has produced, we would find it impossible to indicate any true economic or legal principle of rate making. We could not, however acute our perception, point to any one criterion of reasonableness, and say that it and it alone was sound. Essentially, it would be a subject for business agreement. A lawyer might point out that a certain combination of terms would leave a loophole or an ambiguity not contemplated by the parties. An economist might point out that another combination of terms involved practical consequences injurious to one party or the other. But when both lawyer and economist have had their say, there would still remain a substantial variety of possible adjustments, each different from the other, and each nevertheless accomplishing the primary objects which the parties had in mind.

[1] *Northern Pacific* v. *North Dakota*, 236 U. S. 585 (1915).

CHAPTER V

THE GENERAL LEVEL OF RATES [1]

1. A Change in the General Level of Rates [2]

By the Commission:

This proceeding was instituted upon our own motion for the purpose of determining whether, and to what extent, if any, further general reductions in rates, fares, and charges of carriers by railroad applicable in interstate or foreign commerce may lawfully be required under section 1 or other provisions of the interstate commerce act upon any commodities or descriptions of traffic; and also to determine what will constitute a fair return on and after March 1, 1922, under section 15a (3) of the interstate commerce act. . . .

In *Increased Rates, 1920,* decided July 29, 1920, [58 I. C. C. 220] we designated rate groups as provided in section 15a and authorized substantial increases in freight rates, passenger fares, and certain charges. Late in that year there developed in this country a pronounced and long-continued business depression, nation wide, a phase of the general *post bellum* adjustment throughout the world. Practically all traffic and all industry have been affected. There has been substantial reduction in the price of most commodities without a corresponding reduction in rates. There is a definite conviction in the minds of the shipping public that the present rate level is unreasonably high, is an effective barrier to the return of business activity, prosperity, and the usual volume of traffic, and that it should be substantially reduced.

FAIR RETURN

Section 15a (3) of the interstate commerce act provides:

> The Commission shall from time to time determine and make public what percentage of such aggregate property value constitutes a fair return thereon, and such percentage shall be uniform for all rate groups or territories which may be designated by the Commission. In making such determination it shall give due

[1] See Vanderblue and Burgess, pp. 103–117.

[2] *Reduced Rates, 1922,* 68 I. C. C. 676 (May 16, 1922).

consideration, among other things, to the transportation needs of the country and the necessity (under honest, efficient and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation: *Provided*, That during the two years beginning March 1, 1920, the Commission shall take as such fair return a sum equal to 5½ per centum of such aggregate value, but may, in its discretion, add thereto a sum not exceeding one-half of one per centum of such aggregate value to make provision in whole or in part for improvements, betterments or equipment, which, according to the accounting system prescribed by the Commission, are chargeable to capital account.

In *Increased Rates, 1920*, we exercised the discretion conferred upon us and to the 5½ per cent return added the one-half of 1 per cent during the two-year period to make provision for improvements, betterments, or equipment.

Since August, 1920, the carriers as a whole, or as a whole in their respective rate groups, have failed by a considerable margin to earn the authorized return. It is urged by some that under existing conditions the question of a fair return for the future is academic and that it is not necessary for us to determine a percentage of return at this time. We do not take this view. The operation of economic forces which have prevented, or which may hereafter prevent, carriers from earning a fair return under the adjustment of rates then prevailing does not constitute a bar to determination of what a fair return should be. By the qualifying words "as nearly as may be," Congress recognized that conditions during certain periods might prevent such realization under any adjustment of rates.

The provisions of section 15a in this respect have been framed in recognition of constitutional guaranties of fair return upon property devoted to public use. They also declare the policy of Congress—

in its control of its interstate commerce system * * * to make the system adequate to the needs of the country by securing for it a reasonable compensatory return for all of the work it does. *Railroad Commission of Wisconsin et al.* v. *C. B. & Q. R. R. Co.*, 66 L. ed. (U. S. Sup. Ct.) 236, 42 Sup. Ct. Rep. 232, decided February 27, 1922.

The determination of what will constitute a fair return under paragraph (3) of section 15a is, in our judgment, a function distinct from that of initiating and adjusting rates under paragraph (2) of that section. Section 15a, reasonably construed, contem-

plates the determination of a return which the carriers, collectively or in rate groups, may attain over a period of time under rates adjusted from time to time with that object in view. The phrase "from time to time" does not mean that we should adjust and readjust rates to meet business fluctuations. Whether carriers may be able to earn an aggregate net railway operating income equal to a fair return must depend to a large extent upon business conditions. In the *Wisconsin case*, *supra*, the court said:

> The new measure imposed an affirmative duty on the Interstate Commerce Commission to fix rates and to take other important steps to maintain an adequate railway service for the people of the United States. This is expressly declared in section 15a to be one of the purposes of the bill.

We have before us a practical problem. The record emphasizes the need of a constant influx of capital to meet the country's growing transportation needs. In the 10-year period ending June 30, 1916, a period of relatively low costs of materials, supplies, and labor as compared with present costs, there was a net addition to capital account for new lines and extensions, additions, betterments, and general expenditures properly chargeable to that account which aggregated about 5¾ billion dollars, or an average of 574 millions per annum. According to an exhibit of the carriers, expenditures for such purposes in the 12 months ended September 30, 1921, aggregated about 365 millions, an average of 1 million a day. This omits certain roads not reporting. The carriers estimated that, based on the volume of traffic which they were then handling, capital expenditures in the year 1922 should approximate 458 millions, and that if transportation facilities are to be expanded in 1922 as they should be to provide for a materially increased volume of business, the expenditure this year should be approximately 858 millions, or an average of $2^1/_3$ million dollars a day. Others estimate lesser amounts. Some authorities on transportation and economic conditions place the requirements for the next few years at even higher amounts, to come in part out of earnings, and predict that, unless there is immediate resumption of new construction, a return of anything like normal business will result in "strangulation for lack of transportation." Others are of opinion that the existing transportation machine, if properly maintained, with necessary additions in the way of terminals and track-

age facilities, is adequate to handle the business which may reasonably be expected in the immediate future.

It is obvious that large additions to capital must continually be made. Most of the capital will have to be acquired through the issuance of securities which must be sold in the markets of the world in competition with other classes of securities. Within the next few years the Government must provide for the refunding of some 6 billions of its indebtedness. The carriers must attract money by rates of return and stability of investment. While return must not exceed a reasonable charge against the public served, it must be such as to obtain the needed new capital. It is necessary to determine and make public, as required by section 15a, a percentage of fair return. Determination of the percentage implies, or carries with it, no guaranty. Read in connection with the provision for recapture of one-half of the excess above 6 per cent it is, instead, a limitation.

Because the yield on some railroad bonds has declined to something over 5 per cent it does not follow that a fair return should approximate that percentage. We do not deal alone with interest rates on mortgage obligations, or with the more favorably located and prosperous carriers whose credit conditions may enable them to obtain money at relatively advantageous rates. In the recapture provisions Congress recognized that uniform rates on competitive traffic which would adequately sustain all the carriers would produce substantially and unreasonably more than a fair return for some carriers. We should not take the few, and the highest type of their securities, as the basis for determining what shall be a fair return for all. It can hardly be disputed that the carriers of this country should not continue to provide for all needed capital by successive bond issues. Issuance of bonds in a disproportionate degree unduly increases fixed charges and tends to weaken the credit of the carriers. In such a process eventually a point must be reached where no new capital can be raised, except for short terms at high rates. No substantial proportion of the new capital has been raised by issuance of stock since 1907.

Notwithstanding the failure of the carriers to earn the 6 per cent allowed in the first two years of operation under section 15a, there is an upward trend in railroad securities, which share in the improved conditions that have prevailed generally in the money market. This is urged upon us as an argument for reduction in the percentage to be determined. Other elements, however, are to

be considered. The intent of Congress was to create a steady and reliable flow of money "for enlarging such facilities in order to provide the people of the United States with adequate transportation." A substantial reduction in the percentage of return might be unsettling in its effect, particularly in light of the fact that the return allowed in 1920 was not realized. The fact that a utility may reach financial success only in time or not at all is a reason for allowing a liberal return on the money invested in the enterprise. *Galveston Electric Co.* v. *City of Galveston,* 42 Sup. Ct. Rep., 351, decided April 10, 1922.

In numerous cases cited, courts and regulating authorities of States have recognized that public utilities and railroads may be permitted individually to earn under reasonable rates at least 6 per cent upon fair value. In some instances higher rates of return have been approved. But we are here considering return upon "the aggregate value of the railway property."

The interstate commerce act in many provisions other than those quoted indicates that 6 per cent may be regarded as a fair return. Paragraph (6) of section 15a provides for the disposition of net railway operating income in excess of 6 per cent of the value of the property held for and used in the service of transportation. One-half of the excess goes into a reserve fund, which may be drawn upon for certain purposes, in accordance with paragraph (7), when net railway operating income for any year is less than a sum equal to 6 per cent upon the value. Under paragraph (12) we may make loans from the general railroad contingent fund, such loans to bear interest at the rate of 6 per cent per annum. Under paragraph (14) we may lease equipment or facilities purchased from the general railroad contingent fund, the rental charges to be at least sufficient to pay a return of 6 per cent per annum plus allowance for depreciation. That Congress by direct legislation fixed the fair return for the period of two years beginning March 1, 1920, at the rate of 5½ per cent, to which, in our discretion, we might add not exceeding one-half of 1 per cent, is a matter which may fairly be considered in the determination of the rate for the period immediately ensuing. But, taken in connection with the other provisions of section 15(a), it does not constrain us to consider 5½ per cent as maximum in determining a fair return for the ensuing period.

Under our system of accounts all charges to the account "railway tax accruals" are deducted from railway operating revenues before arriving at railway operating income, and all State and Federal

taxes, income or other, relating to carriers' railway property, operations, and privileges, are charged to that account. This method of accounting was recently sanctioned by the Supreme Court of the United States in *Galveston Electric Co.* v. *City of Galveston, supra.* As indicated by the Court, the net income under this accounting procedure is to the stockholder a tax-exempt income, and this fact should be considered in determining what return shall be deemed fair.

The railway operating income, increased or diminished, as the case may be, by the credit or debit balances in the accounts known as equipment rents and joint-facility rents, becomes net railway operating income, the amount of which is less than it otherwise would be by the amount of income tax accrued or paid. The term "net railway operating income" is defined in paragraph (1) of section 15a. Under paragraph (3), above quoted, rates are to be so adjusted that carriers as a whole or in designated rate groups will earn an aggregate annual net railway operating income equal, as nearly as may be, to a fair return. If this were realized in any instance the carrier would receive that return over and above all taxes, including the Federal tax on income, and if the fair return as determined and made public by us was 6 per cent the carrier would hold that return "tax free" in the sense that after payment of its income tax it would still have left the 6 per cent.

Railway corporations, like all others, are subject to income taxes which, since January 1, 1922, amount to 12.5 per cent on their net income less deductions computed as provided in the income tax law, 42 Stat. L., 277. In our view railway corporations should, like other corporations, pay their Federal income taxes out of the income, rather than collect it, in effect, from the public in the form of transportation charges adjusted to enable it to retain the designated fair return over and above the tax. We may observe that a fair return of 5.75 per cent, representing an aggregate annual net railway operating income arrived at after deducting, among other things, the Federal income tax on a return of 6 per cent, would be approximately the equivalent of a fair return of 6 per cent, out of which the Federal income tax was payable.

RAILWAY PROPERTY VALUE.

In *Increased Rates, 1920, supra,* one of the material facts to be determined was the aggregate value of the properties of the carriers held for and used in the service of transportation. As was pointed

out, the territorial grouping designated by us differs somewhat from that proposed by the carriers; but, inasmuch as the record dealt principally with the three major groups as defined by the carriers, the evidence was considered, in respect to grouping, as presented by the carriers and others then before us.

Upon consideration of all the facts and matters then of record, and those which, under section 15a, we were either required or authorized to consider, we found—

that the value of the steam-railway property of the carriers subject to the act held for and used in the service of transportation is, for the purposes of this particular case, to be taken as approximating the following:

Eastern group, as defined by the carriers........	$8,800,000,000
Southern group, as defined by the carriers.......	2,000,000,000
Western group, as defined by the carriers, including both the western and Mountain-Pacific groups herein designated....................	8,100,000,000
Total...............	18,900,000,000

. . . .

More than 20 months have passed since our former determination, and in that period the valuation of the railroads under section 19a has gone forward. The work is still incomplete, but has progressed to such an extent that we may accept the results with fuller assurance, both as to particular roads and as showing general trends and principles. In our administration of various sections of the act, and in our certification of standard return for the purposes of the Federal control act, we have had occasion to make further investigation and corrections of investment accounts of the carriers.

The various other values and elements of value, as set forth in *Increased Rates, 1920* . . . have been reëxamined in the light of the present record and the requirements of section 15a. We find no present reason to disturb the value taken by us in that proceeding as approximating the sums there stated, except to the extent that subsequent additions to or withdrawals from the property in service, including materials and supplies and working capital, and further depreciation, make adjustment necessary. Whether the value taken by us in 1920 should stand without consideration of these later items or not, the difference would be reflected only in fractions of per cents of the returns hereinafter indicated as the results of operation. . . .

FREIGHT RATES AND CHARGES

The positions of shippers and representatives of the public in this proceeding are diverse. Many urge immediate radical reductions, contending that rates in the aggregate or on particular commodities are unreasonable; that the increases of 1920 contributed to the depression which followed by a few months the date of their establishment; that notwithstanding some readjustments and reductions subsequently made, the existing rate level is preventing a revival of commerce, and, by diminishing the flow of traffic, defeats the desired end of producing adequate net return for the carriers. Others urge that rates be reduced as soon as possible, but express no opinion as to whether reductions should now be made. Most of the general commercial and shippers' organizations urge that reductions when made should apply generally to all rates, as did the increases of 1918 and 1920, but no shipper or shippers' organization urged reductions in fares as well as in rates. Numerous State commissions in the West and South contend that reductions should be made both in rates and in fares. The representatives of certain industries and of a few general organizations urge that reductions be applied only to basic commodities, the staples which are recognized as most important to the economic situation of the country, and which usually constitute low-grade freight.

The carriers are unanimous in the opinion that increased rates have not caused the business depression, which they attribute to generally recognized world-wide readjustments resulting in unfavorable trade and credit conditions, restricted purchasing power, contraction of consumption, and, in many instances, collapse of demand. The carriers contend that the increased rates were not even an important contributing factor in the lessening of traffic in 1921, and that reduction in rates will not restore normal traffic. They do not, however, advocate rate increases as a means to increase net revenue. They admit that rates are too high and must come down, but they insist that rates can not be further reduced until the costs of transportation are further reduced.

Rates generally have been increased twice in the past four years, the increase of 1920 alone having been intended to produce more than one billion dollars additional revenue from the transportation of freight. As wages and cost of materials have been materially reduced since the increases of 1920, it is the position of shippers gen-

erally that the inability of the carriers to earn a fair return since these reductions were made is due largely to the failure of traffic to move in normal volume, and that the most important problem before us is to devise rates that will move more traffic and at the same time be compensatory to the carriers. It is generally recognized that existing high rates are a burden upon commerce, and many shippers insist that they are forcing movement to other forms of transportation, tend to restrict traffic, and in some instances to prevent particular movements. Many complaints are also made relative to the disturbance of relationships between producing or consuming districts due to the manner in which rates have been increased, and to partial readjustments which have subsequently taken place. The belief is general that traffic has been localized and the radius of distribution reduced. One representative witness testified that while his trade in territory within a radius of a hundred miles declined 16 per cent in 1921, as compared with 1920, the volume of his business in territory distant from 500 to 800 miles declined from 30 to 50 per cent.

Some shippers contend that the psychological effect upon industry of existing high transportation charges is as important as the effect in dollars and cents. Agitation of the freight-rate question has been continuous, and the shipping public, aware that transportation charges are still on a high level, is discounting price deflation and withholding purchases in the expectation of lower delivered costs. This has a substantial effect upon the volume of traffic and revenues of carriers. Rate stability is one of the important needs of commerce. It is a fundamental law of business that the anticipation of a falling market tends to restrict purchases. The public does not accept the present rate level as stable because of the belief that rates are too high and must come down.

In the year 1920 there culminated a period of extreme inflation which was followed by a period of depression. At the close of the hearings the depression had existed for approximately a year and one-half. Factors other than transportation charges have been showing a tendency to stabilize upon a level considerably below that of 1920 but higher than the pre-war level. Shippers urged that although rate reductions if made a year ago might not have stimulated traffic, there are reasons for believing that reductions, if made now, would hasten business recovery and result in increased tonnage.

Many shippers contend that such reductions as are made should apply upon traffic generally rather than upon specific commodities. The rate increases of 1918 and 1920 affected all commodities. These shippers say that prior to the general increases the differences between carload rates on low-grade basic commodities and rates on other commodities were as great as were justified by conditions then existing. Those differences have been widened by the percentage method of increasing rates, presumably in accord with changed conditions. The volume of traffic in the various commodities handled by different carriers is far from uniform. For example, the percentage of coal tonnage to total tonnage ranges from 4 per cent on some lines to 85 per cent on others. These shippers urge that, in the absence of proof that rates on particular commodities are unlawful, reductions confined to particular commodities will result in unfair distribution of the transportation burden and deplete the revenues of one set of carriers for the benefit of others. They refer to the many practical difficulties encountered in any attempt to select particular commodities for a general reduction to the exclusion of others, and to the tariff confusion and new commodity rates which will result. One of the needs of commerce is the lessening of the spread in rates between commodities and localities created by the percentage increases of 1918 and 1920. This applies to commodities in general and not merely to basic commodities. Shippers say that carriers' revenues have been depleted in the aggregate by piecemeal reductions, but that the public generally does not recognize such changes as a general lowering of the rate level; that the restoration of confidence and stabilization of business can not be attained by such a process; and that any anticipation that reductions in freight rates will tend to increase confidence and a willingness to purchase can only be realized by reductions more general in extent than if limited to basic commodities.

Evidence was introduced concerning a wide range of commodities. Particular attention was directed to basic commodities, among which may be mentioned coal, iron, and steel and the materials which enter into their manufacture, stone, sand and gravel, brick and clay products, cement, forest products, foodstuffs, agricultural products, and live stock.

Shippers of basic commodities submitted the same general character of evidence relative to the necessity of rate reductions as other shippers, but advocated large reductions upon the basic

commodities even though as a result no reductions may now be made upon other commodities. They urged that generally these commodities constitute low-grade freight which moves in any class of equipment, loads heavily, is subject to little loss or damage in transit, and consequently is desirable traffic for the carriers and entitled to the lowest rates. They also urged that, since the existing rates were authorized, price declines on basic commodities had been more severe than on higher-grade commodities; that their industries as a whole were in a depressed condition; that in some cases the commodities were being sold at a loss; that many basic commodities are important raw materials used in manufacture; that rate reductions thereon will do much to reduce cost of production and to stimulate business; and that generally transportation charges thereon were and are out of proportion to the value of the property transported, and restrict production and movement. . . .

CONCLUSIONS

The carriers take the position that we must be guided solely by those things which are definite and certain in the past. With this we can not agree. Our function under the law is not that of mere computers and can not thus be atrophied. The duty to prescribe rates for the future carries with it the obligation to exercise an informed judgment upon all pertinent facts, present and past, in order to forecast the future as best we may. In *Rates on Grain, Grain Products, and Hay*, [64 I. C. C. 85], we said at page 99:

> * * * The duty cast upon us by section 15a is a continuing duty and looks to the future. It does not constitute a guaranty to the carriers, nor is the obligation cumulative. We are not restricted by past or present statistics of operation and earnings. These are serviceable only as they illuminate the future. What is contemplated by the law is that in this exercise of our rate-making power the result shall reflect our best judgment as to the basis which may reasonably be expected for the future to yield the prescribed return.

When we decided *Increased Rates, 1920*, the country was still in a period of steadily rising prices. We then resolved doubts as to future operating costs in favor of the carriers. In recent months costs have been declining and traffic increasing. Rates of pay for employees have been reduced to an extent which, based upon the light traffic of 1921, is estimated by carriers to aggregate more than $350,000,000 per annum. The Railroad Labor Board

has estimated that the reduction exceeds $400,000,000 per annum, without taking into account changes in rules and working conditions. The tendency is toward increased revenues, lowered costs, and higher net income for the carriers. . . .

It is our duty to initiate such rates as will enable the carriers to earn as nearly as may be a fair return, qualified as provided in the act. In 1920 we authorized large increases in freight rates and passenger fares designed to produce the necessary revenues under the conditions then prevailing. There was then little doubt of the ability of industry to bear the increased charges. The situation has since changed. The country has been passing through a period of abundant supply and slack demand, in which prices at the source have fallen off sharply. High rates do not necessarily mean high revenues, for, if the public can not or will not ship in normal volume, less revenue may result than from lower rates.

Shippers almost unanimously contend, and many representatives of the carriers agree, that "freight rates are too high and must come down." This indicates that transportation charges have mounted to a point where they are impeding the free flow of commerce and thus tending to defeat the purpose for which they were established, that of producing revenues which would enable the carriers "to provide the people of the United States with adequate transportation." In 1921, freight traffic was only slightly more than 10 per cent in excess of that in the year ended June 30, 1915, which was not an unusual year. But the charges for moving freight traffic in 1921 totaled nearly four billion dollars, or about two billion dollars in excess of 1915. Railway operating revenues in 1921 aggregated about 5½ billion dollars, or more than 2½ billion dollars in excess of 1915. If the traffic in 1921 had equaled that indicated as normal by the trend during the 26-year period preceding the war, freight revenues and total railway operating revenues would have exceeded those of 1915 by approximately 2½ billion and 3½ billion dollars, respectively. Without any allowance for pyramiding of transportation charges in goods passing from hand to hand, these figures are significant as explaining, at least in part, existing wide spreads between the amounts received by producers and those paid by consumers.

Manifestly the depression of 1921 resulted primarily from causes other than transportation charges. But it does not follow that under present conditions existing high rates do not tend to retard the return to a more normal flow of commerce. Deflation has

taken place to a greater or less extent in wages and origin prices of commodities in nearly all branches of industry but most transportation charges are still near the peak. In *Rates on Grain, Grain Products, and Hay, supra,* we said at page 100:

> The really vital concern of the carriers, in this situation, is to promote the return of what may be deemed normal traffic, and anything which will help toward this end is greatly to their benefit. So far as a tendency downward in their rates can be induced, and so far as the reductions in wages and prices which have already been made effective can be converted into rate reductions, we are assured that the full return of prosperity will be hastened for both industry and labor.

Practically all agree that stability of freight rates is highly desirable and that normal traffic may not well be expected until the present widespread expectation of rate reductions is realized or dispelled. To assume that rates can or should be stabilized on the present high basis is futile. As already observed, the anticipation of a falling market tends to restrict purchases, and until the public is convinced that there is little likelihood of immediate further material reductions in prices or transportation charges, the confidence necessary to normal business will to that extent be impaired. The period of deflation has been in progress more than 15 months; demand is reviving; prices are showing a tendency to stabilize upon a level much below that of 1920 but above that of pre-war years; and conditions of the agricultural and manufacturing industries have greatly improved in the past few months.

We are of opinion that general reduction in the rate level, as substantial as the condition of the carriers will permit, will tend not only to lessen the transportation burden but also to equalize and stabilize the conditions under which commerce and industry are carried on, with consequent fuller assurance to the carriers of realizing the fair return contemplated by the law.

The results of the three-year period, ended June 30, 1917, were by statute made a criterion for just compensation to the carriers taken under Federal control. The raising of the rate level by the Director General of Railroads in June, 1918, and again under our authority in August, 1920, were necessitated by increases in operating expenses. The latter have now partially receded. The rate increases were general and justified by the increase in general cost of service, and with decrease in that cost a rate decrease, also general, is justified. The justification for decrease

is to be found in the rate structure as a whole rather than in individual rates, or in rates on individual commodities. It is true that the prices of some commodities have receded more rapidly and to a greater extent than others, even as some went up more rapidly and to a greater extent than others. Readjustment, however, is not complete and the process of equalizing prices is still in progress, some coming up and others going down, which will probably result in a more equal price level in the near future. The needs of commerce can not be met if rates are to fluctuate with market prices of commodities. In bringing down the rate level to meet lowered expenses a similar process should be followed and the reduction made generally upon all commodities in substantially equal ratio.

After considering all the facts of record, including the necessity of reasonable expenditures for additions and betterments, we find and determine:

1. That on and after March 1, 1922, a fair return upon the aggregate value of the railway property of the carriers defined in section 15a of the interstate commerce act, determined as therein provided, will be 5.75 per cent of such aggregate property value as a uniform percentage for all rate groups or territories designated by this commission.

2. That the existing freight rates and charges, including charges for switching and other accessorial services and all other charges applicable to freight service which were increased by authority of *Increased Rates, 1920*, will be on and after July 1, 1922, unjust and unreasonable to the extent that they may respectively include more than the following percentages of increase over the rates in effect immediately prior to August 26, 1920, in and between the various rate groups as defined in *Increased Rates, 1920*, 58 I. C. C. 220, 489, and *Authority to Increase Rates*, ibid., 302:

In the eastern group, also between points in Illinois territory and between Illinois territory and the eastern group, 26 per cent instead of the 40 per cent authorized in the decisions last cited.

In the western group, and between the western group and Illinois territory, 21.5 per cent instead of the 35 per cent so authorized.

In the southern and mountain-Pacific groups, 12.5 per cent instead of the 25 per cent so authorized.

On interterritorial traffic, except as otherwise provided herein, 20 per cent instead of the $33^1/_3$ per cent so authorized. . . .

McChord, *Chairman:*

In so far as it results in a reduction of rates I assent to the report in this case, but I am not in full accord with it.

At this time I am opposed to fixing a rate of annual return on the aggregate value of the railway property, and in any event to a rate of 5.75 per cent. If a rate of return is to be fixed at all, I think it should not exceed 5.5 per cent, which was that fixed by Congress at a time when conditions were at their worst and which seems to me not only adequate for present purposes but for future adjustments.

I think that the times and conditions plainly demand reductions in rates on all materials and products that are basic in industry and in our existence as a people to a level that business interests will recognize as the lowest available for some time to come. Nothing less will quiet the prevalent unrest and agitation for lower transportation costs and encourage the needed healthy flow of traffic. The more nearly we approximate the admissible limits of reduction the more effectually will we obtain that stabilization of rates which is conceded to be essential to a full and country wide resumption of business. In my judgment the general reductions, now decreed, fall short of full attainment of the desired end. The record convinces me that the present level of rates on the basic articles is now operating as a serious burden upon commerce and should be materially reduced, and that upon a considerably lower level of rates, with an induced higher level of traffic activity, not only will the carriers secure more net revenue but the prosperity of the country as a whole will be greatly enhanced. The pulse of both industry and transportation is still below normal, although there is and has been for several months marked improvement, and their mutual interests demand a 50-50 readjustment of the very material rate increases under *Ex parte 74*,[1] if reductions are to be made on all classes and commodities, and a still greater reduction if confined to selected commodities. I entertain no doubt of our power and duty under the law to do this. Reductions on that general basis should also be applied to passenger fares.

There is every reason to believe that, with decreases on that basis and the more effectual stabilization of rates, the full amount of the apparent shrinkage in revenues would be more than made up by the expansion of traffic. One-half of the increases by *Ex parte 74* were made the measure of the reductions we prescribed in *Rates on Grain, Grain Products, and Hay*, 64 I. C. C., 85, in the territory embraced

[1] *Increased Rates, 1920*, is so cited by Commissioners McChord and Potter.—Ed.

within the western and mountain-Pacific rate groups; and, certainly as to those commodities, which move in large volume from the West to the East, there can be no defensible prescription of reductions in any less degree in the eastern group, which enjoyed a higher percentage of increase. The report in this case quotes an extract from the report in that case, to the effect that the vital concern of the carriers is in whatever will promote a return to normal traffic movement, which a downward trend in rates will tend to accomplish. The observations there made impress me as having an application commensurate with the wider scope of this case, and the present record presents to my mind no less cogent reasons for equal reductions on other traffic of the country entering essentially into our national welfare.

EASTMAN, *Commissioner*, concurring:

In 1920 Congress provided in the transportation act for the return of the railroads, which were then in the possession of the Government, to their owners in order that they might be privately managed and operated. I was opposed to this early termination of Federal control for the reasons briefly stated in my concurring opinion in *Increased Rates, 1920*, 58 I. C. C., 220, 257, and have since had no occasion to change my views in this respect. But it is clear that we have no more important duty than to administer the provisions of this act in an endeavor to carry out, as nearly as possible, its spirit and intent. The policy which was then adopted after long deliberation, is entitled to the best and fairest test that can be given it, for only in this way can its strength or weakness be fully developed as a guide for future action.

In the *Wisconsin Passenger Fare case*, decided in October, 1921, the Supreme Court has said that the "most novel and most important feature of the act" is section 15a, which "requires the commission so to prescribe rates as to enable the carriers as a whole or in groups selected by the commission to earn an aggregate annual net railway operating income equal to a fair return on the aggregate value of the railway property used in transportation." It declared that "Congress in its control of its interstate commerce system is seeking in the transportation act to make the system adequate to the needs of the country by securing for it a reasonably compensatory return for all the work it does."

Prior to the passage of the transportation act, one of the great complaints of the railroads was that this commission, in the exer-

cise of its control over rates, had been unduly repressive and had not permitted a level high enough to sustain the credit of the carriers and enable them to secure the capital necessary if an adequate transportation system were to be maintained. I think it clear, both from its history and from the internal evidence which it offers, that it was the intent of section 15a to quiet the apprehension of investors and provide a "service-at-cost" system of regulation under which our duties with respect to general changes in rates would be reduced, as nearly as practicable, to a mathematical process.

In one important respect the process is more than mathematical, for it requires speculation as to the future. I entirely agree with what was said in *Rates on Grain, Grain Products, and Hay*, 64 I. C. C., 85, that the "rate adjustment can not with advantage be made dependent upon fluctuations in traffic," that past and present statistics of operations and earnings are "serviceable only as they illuminate the future," and that the law contemplates that "in the exercise of our rate-making power the result shall reflect our best judgment as to the basis which may reasonably be expected for the future to yield the prescribed return." But it is the fair return which we must keep constantly in view, our speculation as to the future must be held within conservative limits, and we can not properly allow ourselves to be influenced by conceptions, dissociated from the act, as to what may or may not promote the general welfare.

At the time of the increase of 1920 I was of the opinion that any valid determination of "aggregate value" was then impracticable. I am of the opinion that it is now impracticable, although more data are at hand, for we have not yet finally determined the principles by which value is to be estimated from the data accumulated. However, the commission has approximated "aggregate value" for the purposes of section 15a, and it is upon this value that the fair return must be based. Using this basis, I am convinced that upon the present record we can lawfully go no further in requiring reductions, if we follow the spirit and intent of section 15a, than we now go.

In this connection, a word as to passenger fares. Neither the statistics before us nor the apparent trend of traffic, in my opinion, justify a reduction in these fares at the present time. The main argument in support of a reduction is that the carriers would gain by the stimulus to traffic more than they would lose by the decrease in

rate per mile. This, however, is not a matter which can be determined with any degree of certainty. It is rather a question of business judgment or wisdom. One of the chief objects of the return of the railroads to their owners was to reap the advantages of the exercise of private initiative. While public regulation is necessarily an interference with management, it was not the intent of the act, as I read it, that we should substitute our judgment for the judgment of the managers under such circumstances as these. But it is not unfair to say that the private managers have here an opportunity to demonstrate to the country the benefits of their initiative.

One further comment. The transportation act provides for the regulation not only of rates and fares but of the wages and working conditions of employees. The latter duty is intrusted to the Railroad Labor Board. While the labor board and this commission are independent bodies, I believe that if the administration of the act is to be as successful as it can be made, the two bodies must act in some degree of cooperation. This was done very successfully in 1920 when the labor board was considering wages at the same time that we were considering rates. It rendered its decision before we rendered ours, so that we were able to cover in our increase in rates and fares the increase in wages which had been found reasonable.

As I understand the law, the regulation of wages is independent of any action that we may take as to rates, but the regulation of rates is necessarily influenced by any action that the labor board may take as to wages. At the present time the labor board has the wages of all railroad employees under consideration; but we are acting without awaiting its decision and our action is, and must necessarily be, based upon existing wages. We have no right to assume or to conclude that wages will be or ought to be reduced. Nevertheless, these wages, which constitute the chief factor in railroad operating expenses, are now on trial and it is at least possible that they will be reduced. If they should be, we must either reopen our proceedings and make a new determination, to the confusion of industry, or the country must forego for a time so large a reduction in freight rates as would have been possible if we had postponed our decision.

It is my best judgment that it would have been wiser and better if we had announced several weeks ago that our decision would be deferred until after the labor board had acted, not for the purpose of in any way prejudging the question of wages or of influencing the action of that body but for the purpose of so timing our own ac-

tion that we might be assured that the rates which we were prescribing would be the lowest possible under the law and the rates most likely to remain stable for some considerable period of time.

POTTER, *Commissioner*, concurring:

The determination that rates and charges will be, on and after July 1, 1922, unjust and unreasonable to the extent that they may respectively include more than the percentages mentioned of increases over the rates in effect immediately prior to August 26, 1920, readjusted as mentioned in the report, is in effect a requirement that present rates and charges shall, generally speaking, be reduced 10 per cent—certain reductions heretofore made to be treated as part of such 10 per cent reduction. The support for the finding that rates and charges should be thus reduced is the belief that the prospective net operating revenues of the carriers for the year commencing July 1, 1922, if under the existing rate basis, would exceed a fair return by the amount involved in the reduction required. This conclusion has been arrived at by calculating what would have been the net operating revenues of the carriers during the year 1921 if there had been in effect during that year the bases of rates and expenses which were in effect at the time of the hearing, say, February 1, 1922, and by adding thereto amounts sufficient to represent the additional net revenue to be derived from a 10 per cent increase in traffic and from further reduced operating expenses in the ensuing year.

While results of future operation are in doubt, due to uncertainty as to the duration of the existing coal strike and other factors, I am convinced that the forecast which we are required to make is justified by present prospects. So far this year there has been a substantial increase of traffic and conditions are improving. There is warrant for the expectation that further reduction of expenses in substantial amount will be realized. In view of the favorable prospect and the industrial and commercial need for lower rate levels, I concur in the conclusion that reductions should be made. If, later, we are convinced that our estimate respecting increased net earnings is not warranted by increased traffic or further reduction of expenses, existing rates can be restored to the extent which then seems necessary.

Notwithstanding the need, which is decreasing, for lower rates, I am not certain that we render a real service to the shipping public in requiring reductions unless and until there is further

reduction of operating expenses. Efficient transportation is more important than cheap transportation. Better service was the demand in the busy and prosperous summer of 1920. The increases then authorized were accepted generally without complaint. Returning prosperity will bring its demand for better service and unfortunately the need will be acute. I apprehend that in the near future shippers will lose and suffer more from inadequate service than could result from the continuance of present rates. But responsibility for ultimate results is not upon us. The transportation act in section 15a limits the return we may allow the carriers. We must accord to shippers the supposed benefit of that limitation.

While the conclusions of the report have the support of the majority of the commission, as most nearly representing the consensus of opinion, it is apparent from the individual expressions that to a considerable extent the views of the majority differ. I call attention to certain respects to which I have preference for different conclusions. Assuming that there is a prospective excess earning available for rate reduction, I think different treatment was required for the following reasons:

1. The percentage increases authorized by *Ex parte 74* resulted in disproportionate increases upon long-haul traffic. The effect was seriously to disturb relationships between competing communities with resulting prejudice and injustice. The short-haul, class rate, and the less-than-carload traffic is less remunerative than the long-haul carload commodity traffic. Therefore, when called upon to eliminate a portion of the increases authorized by *Ex parte 74* we should first correct the injustice of that decision by giving preference in reduction to carload and long-haul traffic.

2. The theory upon which reductions have been made since *Ex parte 74* on certain traffic, instead of on all, was that such reductions were required in justice to the traffic to which they applied, and in order to bring such traffic into proper relation with traffic as a whole. No unlawful preferential treatment was intended when such reductions were made. The reductions now required do not increase the reduction heretofore made upon agricultural products, live stock, and certain other commodities. As the reductions heretofore made were to remove injustice and establish a proper level and relation as between commodities, it seems to me that in distributing the prospective surplus now available for reduction, such commodities should share.

3. I favor a reduction in passenger fares other than commutation fares and without removing the Pullman surcharge.

4. There are not many, familiar with the conditions in the financial world, who would question the propriety of naming 6 per cent as a fair return upon the property values of the carriers which are devoted to the public service. We should have fixed the return at 6 per cent. In *Ex parte 74* we, in effect, fixed the return at 6 per cent. The return contemplated by the transportation act to prevail for two years, if we approved, was 6 per cent and not 5.5 per cent. Within the spirit of the transportation act applicable to present conditions and needs, a proper return would be 6 per cent. We should not be influenced in naming a fair return by our views upon the subject of taxation. Our function is to name a fair return without regard to how much of it the Government may decide to take from time to time in taxes.

During the early stages of our deliberations, I was impressed with the notion that in making reductions we should give preferential consideration to a selected list of so-called basic commodities. Further consideration developed objections to this course which to my mind are convincing. It appears impossible at this time to select a list of so-called basic commodities to which reduction could consistently and lawfully be limited. We can not determine upon specific basic commodities which do not so relate in a competitive way to other commodities, as to make impossible a reduction of the rates on those selected and not on others. The result of applying reductions to a particular list would be to deluge us with complaints from shippers of related commodities who would make charges of discrimination which we would be required to sustain. The effect would be to create intense confusion and discontent and to work great injustice. Concluding that there is a prospective surplus available for rate reductions, I know of no theory on which that surplus, resulting largely from hauling certain traffic, can be made the basis for a finding with respect to the reasonableness of rates on other traffic. If we were to select a list, our difficulties would not be reduced. Some situations are more acute than others. Different commodities and different conditions require different treatment. Some rates are not high enough; others are too high in varying degrees. We would not do justice in requiring horizontal reductions limited to particular commodites. If I were persuaded of the practicability of limiting reductions to the so-called basic commodities, I would favor an announcement of the amount

available for rate reduction and have a further hearing upon the question as to how specific application should be made. The present record is not sufficient to indicate what selections should be made. If further hearings were to cause delay, the result might well be more harmful than to proceed as the report prescribes.

Remaining instances of maladjustment should be corrected upon specific applications. Carriers should not regard our general conclusions as dealing correctly in detail with all situations. Their further consideration in the light of constantly changing conditions, with which they are more familiar than we can be, should lead to sounder treatment than we have directed to be applied. . . .

2. An Industry in Distress [1]

Hall, *Commissioner:*

The complaint in this case, brought by various organizations of stockmen, is directed against all carload rates on ordinary live stock in the territory served by the western and mountain-Pacific groups of carriers as defined in *Increased Rates, 1920,* 58 I. C. C. 220, hereinafter referred to as *Ex parte 74.* They allege that the rates are unjust and unreasonable. A readjustment of individual rates is not asked, but a blanket reduction is sought, based primarily on economic considerations, the contention being that it is impossible for the live-stock industry to thrive under the present rates, and that they tend to injure business generally. The rate-regulating authorities of several of the western states intervened in support of the complaint, as did also certain organizations of stockmen other than complainants.

Most of the important live-stock rates in the west have been prescribed by us. . . . Generally speaking, the rates thus prescribed remained without change for several years. On June 25, 1918, in accordance with general order No. 28 of the Director General of Railroads, all were increased 25 per cent, but not more than 7 cents per 100 pounds, nor more than $15 per standard 36-foot car where rates were stated per car. On August 26, 1920, following Ex Parte 74, they were increased 35, 25, or $33^1/_3$ per cent, according as applied within the western group, within the mountain-Pacific group,

[1] *National Live Stock Shippers' League* v. *Atchison, Topeka & Santa Fé Railway Company,* 63 I. C. C. 107 (August 3, 1921). See Vanderblue and Burgess, pp. 113–117; see also *Interstate Rates on Grain, Grain Products, and Hay,* 64 I. C. C. 85; *Public Utilities Commission of Kansas,* v. *A. T. & S. F. Ry. Co.,* 83 I. C. C. 105; and for a later discussion of the same general economic problems *Rates and Charges on Grain and Grain Products,* 91 I. C. C. 105 (July 10, 1924), especially the concurring opinion of Commissioner Potter and the several dissenting opinions.—Ed.

or between groups. Complainants ask for elimination of both of these general increases and for restoration of the rates in effect June 24, 1918.

Cattle are raised in most of the territory here considered, but in the semiarid belt west of the great grain-growing region, that is, generally speaking, west of the one hundredth meridian, comprising Montana, Idaho, Wyoming, eastern Colorado, and the western portions of North and South Dakota, Kansas, Nebraska, Oklahoma, and Texas, as also in portions of New Mexico, Arizona, Nevada, and California, cattle raising is the principal industry and the mainstay of many urban communities of considerable size, to which the rural population resorts for recreation, education, and trade, and from which building materials, household effects, tools, implements, machines, automobiles, provisions, fuel, and other supplies are drawn. These come in turn from manufacturing and other centers elsewhere. When the live-stock industry is depressed, business throughout this region is depressed, and in other parts of the country is affected to some extent. In the grain-growing region in the eastern part of the territory here considered hogs are produced in great numbers, and cattle, brought from the ranges farther west, are fattened or "finished" for market. Sheep are raised principally in Idaho, Montana, Wyoming, Arizona, and New Mexico; horses and mules in Iowa, Missouri, Kansas, and Nebraska. There is little evidence of record with respect to horses and mules.

The record establishes that the live-stock industry is in a serious condition. The economic readjustment has effected it severely. The financial resources of the average stockman are practically exhausted and he finds it almost impossible to obtain relief. Real estate and live stock are mortgaged and the banks have loaned to their capacity. Interest rates generally range from 8 to 10 per cent but are little above prewar figures. The federal reserve banks will not rediscount live-stock paper unless extremely well secured and maturing in not to exceed six months. Stockmen are having great difficulty in obtaining money for operating expenses and the purchase of new stock to replenish their herds. We understand it to be the view of the Federal Reserve Board that $50,000,000 should be provided for loans to those engaged in the live-stock industry. One of the principal witnesses for the live-stock interests testified that this relief would not go far toward ameliorating the situation.

Stockmen have lost many millions of dollars since the war because of the rapid and severe decline in market prices of live stock. Many have lost the savings of a lifetime. Large herds of "stockers" and "feeders," purchased when prices were high, have been and are being sold upon maturity at much lower figures, with a resulting loss, not only of the difference in price, but of the expense of feeding and care during a period when the costs of labor and feed were at their highest. The situation in the range country is particularly serious. On account of long hauls the freight charge is there a more important item, especially since the general percentage increase of 1920 resulted in increases greater in amount than in the rates for short hauls. The collapse of the wool market left the sheep producers of the northwest in financial straits, and drought conditions there several years ago depleted herds perhaps 20 to 25 per cent, put cattle men to great expense in transferring their animals to other pastures, and greatly handicapped the industry generally. There is now a severe drought in southwestern Texas and southern Arizona and New Mexico. The statement was made in argument that on January 1, 1900, there were 50,563,000 beef cattle in the United States; on January 1, 1910, 41,178,000; and on January 1, 1920, 35,434,000, according to census compilations.

Stock that should be held until further matured is being sold at whatever it will bring. Ranches are not replenished because money is lacking with which to buy new stock, and because conditions, present and prospective, are alike discouraging. Many growers have ceased to raise live stock and many more expect to take the same course. Some continue only because they must, for, like men in other industries, they can not suddenly cease operations and later resume successfully on a normal scale. Years are required to develop a herd of breeding cattle. Indications are that several years must elapse before the industry can wholly recover, even under favorable conditions.

Representative stockmen testify that for years past the industry has been conducted on narrow margins and without much profit. Unless extremely profitable before the war it is difficult to see how it could be profitable now, even for the man who disregards his war losses and starts anew, for, as will be explained in some detail, the costs of production are still somewhat higher than in prewar times and the selling prices have declined to nearly the basis of 1913 to 1915, inclusive.

Labor costs, which constitute one of the principal items of expense, are still somewhat higher than before the war. The cost of food for the laborers is much above the prewar figure. Many leases on grazing lands made several years ago at high figures have still about a year to run. Stock feeds, such as corn, alfalfa, and cottonseed meal, especially when drawn from distant points, cost considerably more than formerly. Maintenance costs and taxes have greatly increased. So have the charges made by commission men for selling stock on the markets, which in many cases are double what they were before the war. These charges constitute an important item of expense, as they generally range from $12 to $24 per car, dependent upon the market, the kind of stock, and, in the case of sheep and hogs, the mode of loading, whether in single or double deck cars. Only a few commission men have reduced their charges since the war. Shippers must pay the carriers $1 per car for bedding and $2.50 per car for disinfecting. Formerly these charges were not made. Feeding-in-transit charges and charges for switching, yardage, and other services at terminals have been substantially increased. In addition to all these is the substantial increase in freight rates. Those which immediately prior to 1918 were 28 cents per 100 pounds or less were increased under general order No. 28 and Ex Parte 74 about 68 per cent. For longer hauls the ratio of increase greatly diminishes but in no case is it less than 40 per cent.

In most markets the prices of live stock, except possibly stock cattle, bear a relation to prices at Chicago. The proceeds realized by the shipper on stock sent to market are based on the price at that market less the transportation, feeding-in-transit, and marketing charges. Market prices are near the prewar levels. It is difficult to state the situation exactly, because of the daily fluctuations, and comparisons vary according to the prewar and postwar periods used in arriving at average figures. It will be seen from the following table that on beef cattle and hogs the present prices are somewhat above those which prevailed during the period from 1910 to 1914:

AVERAGE PRICES PER 100 POUNDS OF NATIVE BEEF CATTLE (900 TO 1,900 POUNDS) AT CHICAGO

MONTH.	AVERAGE, 1910–1914	1913	1914	1915	1916	1917	1918	1919	1920	1921
January	$7.09	$7 80	$8.45	$8.05	$8.35	$10,15	$12.10	15.80	$13.95	$8.70
February .. .	7.13	8.25	8.30	7.50	8.35	10.50	12.00	15.95	13.05	8.20
March	7.48	8.30	8.35	7.65	8. 5	11.25	12.60	16.05	13.10	9.05
April.	7.59	8.15	8.50	7.70	9.10	11.75	14.70	15.85	12.30	8.15
May..........	7.56	8.00	8.40	8.35	9.50	11.90	15.40	15.00	12.25	8.25
June	7.66	8.15	8.60	8.80	9.85	12 15	15.85	13.55	14.95	....
July	7.67	8.25	8.80	9.20	9.25	12.35	16 05	15.60	15.00	....
August ...	7.94	8.30	9.10	9.05	9.45	12.70	15.75	16.45	14.85	....
September....	7.92	8.50	9.35	8.95	9.40	13.10	16.00	15.50	15.05	....
October	7.74	8.40	9.05	8.80	9.75	11.70	14.80	16.15	14.20	....
November ..	7.57	8.25	8.60	8.70	10.15	11 10	15.05	15.10	12.00	....
December .	7.41	8.20	8.35	8.35	10 00	11.40	14.90	14.35	10.10	.. ...

AVERAGE PRICES PER 100 POUNDS OF HOGS (ALL GRADES, EXCEPT PIGS) AT CHICAGO

January.. .. .	7.70	7.45	8.30	6.90	7.20	10.90	16.30	17.60	15 00	9.40
February.....	7.88	8.15	8.60	6.80	8.20	12.45	16.65	17.65	14.55	9.35
March.... ...	8.42	8.90	8.70	6.75	9.65	14.80	17.10	19.10	14.95	9.90
April	8.33	9.05	8.65	7.30	9.75	15.75	17.45	20.40	14.90	8 50
May..........	8.04	8.55	8.45	7.60	9.85	15.90	17.45	20.60	14.30	8.35
June	8.01	8.65	8.20	7.60	9.70	15.50	16.30	20.40	14.70	....
July.	8.17	9.05	8.70	7.25	9.80	13.20	17.75	21.85	14.85	....
August.	8.25	8.35	9.00	6.90	10.30	16.90	19.00	20.00	14.75	....
September . .	8.28	8.30	8.85	7.25	10.70	18.20	19.65	17.45	15.90	....
October......	7.91	8.20	7.65	7.90	17.15	17.15	14.35	14.35	14.05	....
November....	7.38	7.75	7.50	6.65	9.60	17.40	17.70	14.20	12.20	....
December .. .	7.25	7.70	7.10	6.40	9.95	16.85	17.55	13.60	9.55	......

The record does not afford like data as to sheep and lambs. If the years 1913 to 1916, inclusive, be taken as the prewar period, the difference between the prices prevailing then and now is even less marked. The following table compares that period with the first five months of 1921:

	1913–1916		1921	
	Range of average prices.	*Average.*	*Range of average prices*	*Average.*
Beef cattle......................	$7.50 to $10.15	$8.70	$8.15 to $9.05	$8.45
Hogs..........................	6.40 to 10.70	8.35	8.35 to 9.90	9.10
Sheep..........................	4.30 to 9.00	6.25	4.75 to 6.45	5.65
Lambs......	6.85 to 12.70	8.85	9.20 to 11.10	10.10

Prices mounted gradually during that period and have fluctuated considerably this year. In the following table the average 1913 Chicago prices are taken as 100 per cent and the level of average prices there for succeeding years is indicated by a higher or lower percentage:

Period.	Beef cattle.	Hogs.	Sheep.	Lambs.
	Per cent.	Per cent.	Per cent.	Per cent.
1913	100	100	100	100
1914	105	99	107	104
1915	102	85	121	116
1916	115	115	151	139
1917	141	181	212	201
1918	178	209	234	215
1919	188	214	196	207
1920	161	169	179	188
Jan., 1921	105	113	95	139
Feb., 1921	99	112	91	117
Mar., 1921	110	119	112	123
Apr., 1921	98	102	124	122
May, 1921	100	100	120	144

It is apparent that the increase in prices, particularly of cattle, hogs, and sheep, do not measure up to the increase in the expense of producing and marketing. The indications are that the live-stock grower, at best, is not receiving, and will not receive, if present production and marketing costs and selling prices continue, more than a nominal return over and above out-of-pocket costs.

The present relatively low prices of live stock are due to a number of causes which it is not necessary here to discuss, one important factor being the high retail prices still exacted for meats in spite of the reduced purchasing power of the average consumer.

Stockmen seem to be doing what they can to help themselves. They say that freight charges constitute the only items of expense, aside from commission charges, and presumably taxes, which are at their highest, and urge that the public good demands a prompt reduction to relieve the situation. Many factors have contributed to the present distress, but the freight-rate burden is one which, in their opinion, can and should be lifted. Complainants point out that the value of live stock is far below what it was when Ex Parte 74 was heard, and that the value of the commodity is one of the important considerations in rate making; also that the value of the service to the shipper, and what the traffic can bear, are generally given careful consideration, and may sometimes take precedence over revenue considerations.

As the stock matures, most of it must be marketed. Freight rates have not appreciably reduced the movement. There has been some reduction since 1918 and 1919, when the movement was greatest, but for 1921, judging by the figures for the first four or five months, it promises to equal or exceed that prior to the war. Complainants do not seek reduction in the rates on the ground that it would substantially increase the present movement, but

on the plea that it would stimulate the industry, enable it more quickly to recoup its losses, help save it from ruin, preserve it as a future and continuing source of traffic for the carriers, and give the stockmen more purchasing power, thereby tending to hasten restoration of better conditions.

Emergency reductions were made in May, 1921, and are still effective, in rates on stock or range animals from ranges of the southwest to pastures in the north and east. These reductions eliminated the entire increase made under Ex Parte 74, and have resulted in rates in no case more than 7 cents per 100 pounds higher than in prewar years. There is nothing to show that these reductions have materially increased the movement of stock animals; on the contrary, this movement has apparently been lighter this season than in former years.

The difficulties encountered by defendants in the endeavor to keep their roads in operation are a matter of common knowledge and need not be considered in detail. It is manifest from the evidence that defendants are in no position to suffer extensive reductions in operating revenues. They state that the annual movement of live stock in this territory is approximately 1,400,000 cars, on which freight charges of approximately $86,000,000, or an average of $66 per car are paid. At the present market prices the value of a car of live stock is about $1,800. Defendants estimate that on the basis of their 1919 traffic the reductions sought would lessen their revenues by about $34,000,000. If only the increases under Ex Parte 74 were taken off the diminution in revenue estimated would be about $22,500,000. These estimates may exceed the mark as applied to 1921, for the reason that the tonnage in 1919 was somewhat greater than it apparently will be in 1921.

Defendants have introduced much evidence in support of their contentions that if there is any commodity which should be excepted from a reduction in rates it is live stock; that the present rates contribute to the revenues of the carriers in less proportion than do the rates on many other commodities of importance; that judged by the usually recognized standards they are relatively low for the service performed; that they have not been increased as much in the past 10 years as many other rates; and that, on account of the light loading, a condition which probably can not be remedied because of the inherent nature of the traffic, the car-mile earnings are low.

Defendants undertook on brief to condense in tables the substance of voluminous exhibits. From their brief are taken the following tables:

Commodity.	C. & N. W.[1]		C. M. & St. P.[1]		Nor. Pac.[1]		Tex. & Pac.[1]		M. K. & T.[1]	
	Average Haul	*Car-mile Earnings*	*Average Haul*	*Car-mile Earnings*	*Average Haul*	*Car-mile Earnings*	*Average Haul*	*Car-mile Earnings*	*Average Haul*	*Car-mile Earnings*
	Miles.	*Cents.*	*Miles.*	*Cents.*	*Miles.*	*Cents.*	*Miles*	*Cents.*	*Miles.*	*Cents.*
Live Stock	243	24.21	209	21.00	318.8	22.47	196	22.70	293	15.08
All Carload Freight	188	34.15	194	29.91	...	...	185	34.13	259	32 34
Products of Mines	136	42.57	.....	......	166 1	39.78	......	......	147	36.14
Manufactures and Miscellaneous	204	37.27	......	......	479.3	31.61	.....	......	267	16.34
Products of Animals	250	25.42	......	......	......	......	......	....	470	25.78
Grain	220	48.54	275	46.05	......	.....	....	....	[2] 297	31.58

[1] C. & N. W. figures are for October, November, and December, 1920, thus reflecting advanced rates under Ex Parte 74. C. M. & St. P. figures are for June, 1920. M. K. & T. figures are for the [illegible] of 1920. Other figures are for the calendar year 1920.
[2] Includes all products of agriculture.

Commodity.	C. & N. W.		Nor. Pac.	
	Average Haul	*Car-mile Earnings*	*Average Haul*	*Car-mile Earnings*
	Miles.	*Cents.*	*Miles.*	*Cents.*
Live Stock	226	20.45	318.8	22.47
Grain	224	40.26	......	....
Hay, etc.	188	17.63	......	....
Fresh Meats	303	20.22	325.3	33.22
Packing House Products	211	26.07	637.4	36.67
Poultry	372	34.21	238.4	56.09
Eggs	378	28.11	701.7	32.07
Butter and Cheese	256	36.58	341.7	44.60

Commodity.	C. B. & Q. R. R.	
	Average[1] Haul	*Car-mile Earnings*
	Miles.	*Cents.*
Cattle	447	21.85
Hogs	447	19.40
Sheep (single deck)	358	14.77
Sheep (double deck)	447	20.82
Fresh Meats	411	21.75
Packing House Products	411	29.26
Butter	447	58.34
Eggs	447	53.85
Dressed Poultry	447	53.85
Live Poultry	447	46.97
Grain	447	52.84
Hay	447	18.92
Agricultural Implements	447	44.53

[1] Average distances from certain points to certain markets.

It will be noted that hay and, over the Burlington, fresh meats are the only commodities shown which yield car-mile earnings as

low as or lower than those on live stock. On the Chicago & North Western, for example, 12.9 per cent of the entire carload traffic for 1920, as measured by car-miles, was live stock, but it yielded only 7.9 per cent of the total carload revenue.

Many items of expense incident to the transportation of live stock are not met in handling other traffic. Loss-and-damage claims are unusually heavy. Special facilities must be provided for loading. The special and expedited service needed results in expensive delays to other traffic. Caretakers are carried free. Most of the cars are handled empty in one direction, which is not the case as to most other traffic. The incidents and peculiar characteristics of the traffic have been considered at length in the cases cited, and need not be further detailed here. Moreover, as above stated, except for two general increases, that made by the Director General and that authorized by us in Ex Parte 74, the rates are for the most part those fixed by us in previous cases.

Although not excessive, considered as a whole, from a transportation standpoint, should we nevertheless require that they be substantially reduced to assist in tiding the live-stock industry over its present period of adversity and to hasten a return of better conditions and business prosperity?

The complaint covers all rates on live stock in the territory west of the Mississippi River and Chicago. These range approximately from 10 cents to $1.25 per 100 pounds. Among the lower rates which move a large volume of traffic are those to Chicago from the Missouri River, 40 cents on cattle and 47 cents on hogs, and those from central Iowa, 37 and 40 cents on cattle and hogs, respectively. Among the higher rates on cattle and hogs which move a considerable volume of traffic are those to Chicago from western Montana, e. g., Helena, $1.015 and $1.125, respectively, and from Texas, e. g., San Antonio, 90.5 cents and $1.105, respectively.

The increases made since 1917 amount to 15 and 32 cents per 100 pounds, respectively, in the cattle rates from Des Moines and Helena to Chicago, approximately one-sixth and one-third of a cent per pound of cattle. Since 1919 cattle and hogs have declined in market price approximately 7 and 8 cents per pound, respectively. These declines represent, in amount, from 20 to 40 times the increase in freight rates since 1917. It is difficult to deduce from these figures that increases in live-stock rates can have been

an important factor in bringing about the present deplorable situation, nor does it seem that the reductions sought would of themselves materially relieve that situation. Transportation charges on live stock represent on the average less than one-twentieth of the present market prices, and it may be doubted whether free transportation of live stock at this time would substantially lessen the ills under which the industry is suffering. Nor is it clear to what extent the producers of live stock would receive the benefit of the general reduction sought.

Complainants have made their record and presented their case largely on the basis of economic necessity. Little evidence was introduced by them as to the reasonableness of specific rates or groups of rates. They do not seriously assail the live-stock rate structure, in the main prescribed by us, as it existed prior to the increases made by the Director General under general order No. 28. They seek removal of that increase, and of the subsequent increase authorized by us under *Ex parte 74*, as applied to the preexisting structure, without distinguishing between its several parts.

Defendants have met the issue thus presented with evidence as to the reasonableness of the present rate structure as a whole, judged by the recognized transportation standards. It has been suggested that to these standards should be added another, that of economic necessity; that the carriers as public servants should bear part of the public burdens; and that we may find unjust and unreasonable a rate structure which is not relaxed to relieve the needs of an industry. Put in another way, the proposition is advanced that we may find existing rates unjust and unreasonable, and require that they be reduced below what would be justified by standards heretofore recognized, because an industry is not prospering. If that be true, then the converse must be true, that at times when the industry prospers we may find justified rates higher than those which under accepted standards would be just and reasonable. If true of this industry, it must be true of other industries that languish or flourish, now and hereafter; and if true of industries, why not true of localities or individuals? The answer is that the foundations of what is just and reasonable are not set on such shifting sands. Essentially the proposition is not new and has been dealt with and disposed of long ago.

In *Railroad Commissioners of Kansas* v. *A., T. & S. F. Ry. Co.*, 22 I. C. C., 407, at 410 we said:

This Commission has often said that it can not require of carriers the establishment of rates which will guarantee to a shipper the profitable conduct of his business. The railway may not impose an unreasonable transportation charge merely because the business of the shipper is so profitable that he can pay it; nor, conversely, can the shipper demand that an unreasonably low charge shall be accorded him simply because the profits of his business have shrunk to a point where they are no longer sufficient.

The effect of a rate upon commercial conditions, whether an industry can exist under particular rates or a particular adjustment of rates, are matters of consequence, and facts tending to show these circumstances and conditions are always pertinent. But they are only a single factor in determining the fundamental question. A narrowing market, increased cost of production, overproduction, and many other considerations may render an industry unprofitable, without showing the freight rate to be unreasonable.

Similar exposition may be found in *Railroad Commissioners of Montana* v. *B., A. & P. Ry. Co.*, 31 I. C. C., 641, and many other cases.

Another aspect should be considered. Carriers subject to the interstate commerce act have been required since its enactment in 1887 to establish and maintain just and reasonable rates. The initiation of those rates has lain with them. Since 1910 we have had power to suspend new rates and in proper case to require their cancellation before they go into effect. Since 1910, also, the burden of proof to show that an increased rate is just and reasonable has been upon the carrier. The words "just and reasonable" are not defined in the statute. For more than 30 years and in many thousands of reported cases the criteria and standards of reasonableness now generally recognized and accepted have been gradually developed and established for the guidance of carriers and shippers alike.

The carrier, in essaying to perform its statutory duty of initiating just and reasonable rates, should not be misled by any subordination or rejection in this case of standards bedded in reason and justified by experience. We, therefore, restate that, in considering the reasonableness of rates, industrial prosperity or adversity may be taken into account, with other factors, but can not dominate them.

The right of a railroad to charge a certain sum for freight does not depend at all upon the fact of whether its customers are mak-

ing or losing by their business. *Union Pacific Railroad Co.* v. *Goodrich*, 149 U. S., 680, 695.

We have always recognized the right of carriers to so adapt their rates and practices to the needs of the localities and industries which they serve as to promote the welfare of shipper and carrier alike, where that can be done within the limits of reasonableness and without the undue prejudice and unjust discrimination which the law prohibits. In this we have recognized their right to do what we could not require them to do. We are now asked to impose upon them an economic policy against their will, because the live-stock industry is not prospering under the impact of many and world-wide influences, in which the rate structure plays at best but a minor part. The record as made will not support a finding that the rates assailed, as a whole, are unjust and unreasonable.

But there are other features of the rate situation which should be considered.

In *Ex parte 74* we found that the percentage increases there authorized—

> would under present conditions result in rates not unreasonable in the aggregate under section 1 of the act and would enable the carriers in the respective groups, under honest, efficient, and economical management and reasonable expenditures for maintenance of way, structures, and equipment,

to earn the aggregate annual railway operating income set as a mark by Congress. Of this they have fallen short, for the reasons, among others, which afflict complainants' industry. We referred to the considerable evidence presented with respect to rates upon individual commodities, live stock among others, and we said:

> It would be desirable, if it were possible, to determine definitely the commodities, the sections of the country, and even the individual rates which can best bear the burden of increases, and the relationships of the rates and differentials which will be disturbed by a percentage increase. This is precluded by the necessity of prompt action upon the main issues presented.

In the closing paragraph of our report we said:

> Most of the factors with which we are dealing are constantly changing. It is impossible to forecast with any degree of certainty what the volume of traffic will be. The general price level is changing from month to month and from day to day. It is im-

practicable at this time to adjust all of the rates on individual commodities. The rates to be established on the basis hereinbefore approved must necessarily be subject to such readjustments as the facts may warrant. It is conceded by the carriers that readjustments will be necessary. It is expected that shippers will take these matters up in the first instance with the carriers, and the latter will be expected to deal promptly and effectively therewith, to the end that necessary readjustments may be made in as many instances as practicable without appeal to us.

Such readjustment between shippers and carriers has not been made in rates on ordinary live stock moved to market.

The importance of stock raising to the general economic situation in the range country lying, generally speaking, west of the one hundredth meridian, has been noted. Because of the long hauls, and for other reasons, rates on live stock from this general territory to packing centers in the middle west have always been relatively high. In a general way this is also true of all rates in western territory for the longer hauls. The percentage basis of increase applied in 1920 to the higher rates for the longer hauls resulted in greater increases per unit than in the rates for shorter hauls. It may be that reductions in the higher rates at this time will, as claimed by complainants, benefit the carriers as well as the live-stock industry.

Manifestly the higher long-haul rates, such as that on cattle from Helena, Mont., to Chicago, \$1.015 per 100 pounds, are of greater importance to and have greater effect upon the transportation and marketing of live stock than the lower short-haul rates, such as those applicable from Des Moines to Chicago, 37 cents on cattle and 40 cents on hogs, respectively.

Having in mind the present value of live stock, and other factors, it is our view that under present conditions the carriers should themselves reduce all live-stock rates in western territory, except those on horses and mules, which are higher than 50 cents per 100 pounds and that this reduction should be made to the basis of 80 per cent of the present rates but not less than 50 cents per 100 pounds. Readjustment of the existing rates on this basis would seem to accord with the closing paragraph, above quoted, of our report in *Increased Rates 1920, supra,* would effect reductions in the rates to Chicago from most of the territory lying west of the Missouri River and, from a considerable portion thereof, would in large measure eliminate the rate increases made under that decision. Thus, the rate on cattle from Helena, Mont., to Chi-

cago was 75 cents prior to the 1920 increase and the present rate reduced 20 per cent will become 81 cents.

No order will be entered at this time, and the record will be held open. Rates in conformity with the suggestions contained herein may be published to become effective on not less than five days' notice.

McChord, *Commissioner:*

In my judgment, the case stated in the majority report calls for one or the other of two things, viz, a dismissal of the complaint or the entry of an order awarding specific relief; and, as I comprehend the record, I think we should prescribe a substantial reduction in these rates.

Campbell, *Commissioner*, dissenting:

I can not but express the view that we would have been fully justified in this case in making an absolute and definite finding of unreasonableness as to rates for both long and short hauls and entering an order requiring a reduction, instead of merely suggesting it and holding the record open for more affirmative action should that become necessary. I must hark back to the inception of section 1 of the act. It was enacted for the protection of the shippers, and the words "unjust and unreasonable" were put there, among other reasons, for the purpose of restraining the carriers from exacting rates which were more than the reasonable value of the services, or greater than the shipper could reasonably afford to pay for the service required. The books are full of decisions, both by the courts and this Commission, construing the words "just and reasonable." Many are in point and fully support the theory on which this case was presented.

In *Alexandria & W. Ry. Co.* v. *Railroad Commission,* 79 So. 863, the court says:

In order to ascertain what constitutes a just and reasonable rate two fundamental principles must be considered and followed —the right of the carrier to a fair return on its investment, and the right of the public to be charged no more than the reasonable value of the services.

And in 4 R. C. L. 635, 636, we find:

In arriving at a determination of what is a reasonable rate the interest both of the public and of the carrier should be considered, but it is not always possible to do full justice to both, and where

this is the case the rights of the public must prevail. And so it naturally follows that as the charge approaches oppression to the shipper, it should in the same degrees approach the point of minimum profit to the carrier. Ordinarily however the carrier is entitled to reasonable compensation, the determination of which by the court is usually an embarrassing question.

In *Puget Sound Electric Railway Co.* v. *Railroad Commission*, 117 Pac. 739, the court says:

Hence, in determining the reasonableness of railway rates, consideration must be given, not only to the carrier, but to the individual requiring the service. The carrier is entitled to an adequate recompense for the service it performs. The individual is entitled to a rate that he can reasonably afford to pay for the service he requires. Upon this point both judicial and economic authority agree. "It can not be said that a corporation is entitled as of right and without reference to the interests of the public to realize a given per cent upon its capital stock." When the question arises whether the legislature has exceeded its constitutional power in prescribing rates to be charged by a corporation controlling a public highway, stockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored. It is alleged here that the rates prescribed are unreasonable and unjust to the company and its stockholders but that involves inquiry as to what is reasonable and just to the public. * * *

And the Supreme Court of the United States in the well-known case of *Smyth* v. *Ames*, 169 U. S. 466, held, as indicated by the syllabus:

A railroad is a public highway, and none the less so because constructed and maintained through the agency of a corporation deriving its existence and powers from the State. Such a corporation was created for public purposes. It performs a function of the State. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public. It is, therefore, under governmental control—subject, of course, to the constitutional guarantees for the protection of its property. It may not fix its rates with a view solely to its own interests, and ignore the rights of the public; but the rights of the public would be ignored if rates for the transportation of persons or property on a railroad were exacted without reference to the fair value of the property used for the public or of the services rendered, and in order simply that the corporation may meet operating expenses, pay the interest on its obligations, and declare a dividend to stockholders.

From these authorities it is clear to my mind that rates can go no higher than the service is reasonably worth to the public requiring the service and that the reasonable value of the service to the public may be insisted upon even though rates so limited would fail to produce the desired return to the carriers upon the investment which they might feel they were entitled to have used as a basis, so long as the rates charged for the particular service in question did not reach the point of confiscation. I may call attention to the fact that paragraph (*a*) of sec. 15a of the act, which requires us to fix rates to yield the prescribed return on the estimated value of the carriers' properties devoted to the service of transportation, contains the following proviso:

Provided, That the Commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust and unreasonable, and to prescribe different rates for different sections of the country.

The words "unjust and unreasonable" may have a new and larger meaning than formerly. In any event, it is evident that Congress realized that blanket increases applied to traffic generally might be wholly unsuited to certain individual commodities. Moreover, it is axiomatic that all commodities can not be expected to yield the same degree of profit.

I am firmly convinced that under the act of 1920 we are virtually responsible for the revenue of the carriers. And there is no one more interested in maintaining transportation facilities at their very highest point of efficiency than I am, but we can not lose sight of the fact that rates must be no higher than just and reasonable, and that we are charged with the maintenance of rates that are made not only with the present in mind but the future also. In other words, it is our duty, to the extent that it is humanly possible, to so regulate rates as to provide traffic for the carriers in the future as well as at present. It would be very short-sighted policy to maintain rates so high as to be unduly burdensome upon an industry and to thus threaten its future traffic.

For the above reasons I express my keen disappointment that the majority did not see fit to proceed upon this record as now made and require a reduction in the rates.

CHAPTER VI

VALUATION AND THE RECAPTURE OF EARNINGS [1]

1. VALUATION BY THE INTERSTATE COMMERCE COMMISSION: THE FLORIDA EAST COAST CASE [2]

BY THE COMMISSION:

A tentative valuation of the properties of the Florida East Coast Railway Company and Atlantic and East Coast Terminal Company was completed and notice thereof given to the carriers concerned and other interested parties on August 11, 1921. Protests were filed within the statutory period by the Florida East Coast Railway Company, the Atlantic and East Coast Terminal Company, and the Atlantic Coast Line Railroad Company. A hearing has been had on the issues presented by the protests and briefs have been filed. . . .

The carrier in its protest as originally filed alleged that the sum of $47,646,143, composed of $46,931,947, which we found to be the value of the property wholly owned and used by it, and $714,196, the value of the property used but not owned by it, leased from the Terminal Company, the Atlantic Coast Line, and private parties, is inadequate and insufficient to the extent that it is less than $55,545,524. At the hearing the carrier amended its protest to claim a value of $60,000,000. This sum is composed of the amounts reported by us for cost of reproduction new of common-carrier property other than land wholly owned and used, and used but not owned, the amount of working capital, including materials and supplies on hand on valuation date, and the amount which we ascertained to be the present value of the lands owned and used and used but not owned, aggregating in all $50,141,822, plus $2,882,044 for the present cost of acquisition of lands owned and used, and used but not owned, in excess of their present value, and $6,970,598 for cost of development. The value of the Terminal Company's property is claimed to be $1,878,646, instead of $1,200,000 as reported by us. This value is determined by adding to our re-

[1] See Jones, pp. 264–268, and Vanderblue and Burgess, pp. 325–352.

[2] *Florida East Coast Railway Company and Atlantic and East Coast Terminal Company*, 84 I. C. C. 24 (January 15, 1924).

ported cost of reproduction new and present value of lands the amount of $548,158 which we found to be the present cost of

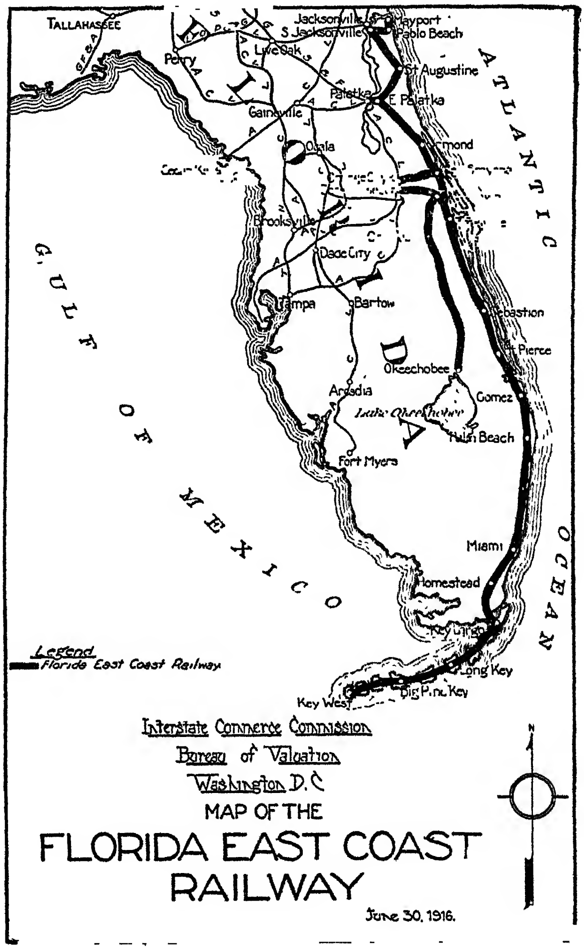


PLATE 4.

condemnation and damages or purchase of lands owned but not used devoted to common-carrier purposes.

It thus appears that the values for which the carriers contend are built up by adding together the cost of reproduction new, without deduction for depreciation, the excess cost of acquisition of carrier lands, materials and supplies, and cash on hand, and, in the case of the carrier, an amount approximating $7,000,000 for cost of

development, or, as it is also termed by the carrier, going-concern value.

DEPRECIATION

The carriers contend that in so far as our final values reported are based upon the cost of reproduction less depreciation, they are insufficient because no legal or economic justification exists for deducting theoretical depreciation in the absence of an accumulation of deferred maintenance. They submitted evidence tending to show that the properties were fully maintained on valuation date and that no further expenditures could economically have been made. Since the decision of the Supreme Court in *Knoxville* v. *Water Co.*, 212 U. S. 1, courts and commissions have accepted, as a settled practice in valuation proceedings, the deduction from reproduction new of the depreciation accrued in that which theoretically is being reproduced. The Congress in its mandate has required the commission to report cost of reproduction new and also reproduction less depreciation. There is, therefore, both legislative and judicial authority for this finding. . . .

VALUE OF LAND

The present value of the lands owned and used by the carrier as found in our tentative valuation is $4,406,448, and of the lands owned by the Terminal Company $1,034,258. We also found that to acquire these lands on valuation date the carrier would have been required to expend $2,607,264, and the Terminal Company $548,158, in excess of the present value of the land. The carrier and the Terminal Company contend that in our determination of final values we should add to the present values of their lands the amounts which they would necessarily expend in a theoretical reacquisition of them.

We have determined the present values of these lands by ascertaining the number of acres owned or used for common-carrier purposes and multiplying this acreage by fair average market values determined from the present market values of similar lands in the vicinity. . . . The application of this method is supported by the decision of the Supreme Court of the United States in *The Minnesota Rate cases,* 230 U. S. 352, in which the court said:

The company would certainly have no ground of complaint if it were allowed a value for these lands equal to the fair average mar-

ket value of similar lands in the vicinity, without additions by the use of multipliers, or otherwise, to cover hypothetical outlays.

This ruling of the Supreme Court is full authority for disregarding present cost of acquisition of carrier lands in arriving at the value of the property of a carrier.

At the time our tentative report was prepared and served, section 19a of the interstate commerce act required us to report separately as to lands the original and present cost of condemnation and damages or of purchase in excess of original cost or present value. By amendment approved June 7, 1922, this requirement was stricken from the act and we are now required to ascertain and report only the original cost and present value.

COST OF DEVELOPMENT

The carrier protests that on valuation date it had the use and enjoyment of property not owned by it, possessed valuable contracts, and had an assembled plant not only capable of earning money but actually earning money, and contends that for these and other reasons the properties had in addition to their bare structural value a going-concern value which should be included and allowed for in the determination of final value. The term going-concern value is used by the carrier synonymously with cost of development. The contention of the carrier is that the tentative valuation only reproduces the property to the point where the physical plant is ready to begin operations and makes no allowance for the cost of vitalizing it; of finding men to compose the personnel of the organization; of finding and bringing to it the traffic which it is capable of transporting; and of developing it into the active, successful, and efficient plant that existed on valuation date. No figures are in existence which would indicate the amount of money expended by the carrier to bring about this condition of efficient and successful operation, but a method is suggested by which, it is claimed, this expense may be calculated.

In order to ascertain the length of time for a new carrier to develop its business, a comparison was made of the actual experience of 11 new roads during a series of years following their construction, as contrasted with the experience of 11 comparable old roads during the same years. The annual operating revenues per mile were computed and averaged and the averages were plotted on a chart. The chart, it is claimed, shows that at the expiration of seven years the revenues per mile of the new roads increased annually in about the

same proportion as the revenues of the old roads, whereas until that time had elapsed they increased much more rapidly, especially during the first two or three years. The period during which the new roads were building up their business to approximate that which they enjoyed after conditions had become stabilized was therefore determined to be seven years , although an examination of the exhibit filed by the carrier indicates that it might as readily be concluded that four or five years constituted this so-called development period.

Assuming that the period was seven years, it was found that the revenues per mile of the first year's operations averaged 41.13 per cent of the revenues per mile in the seventh year, that in the second year the proportion was 57.38 per cent, in the third year 70 per cent, and so on. Having ascertained the development period it became necessary to find the difference between the aggregate of the annual net railway operating income of the carrier reproduced new on valuation date for the period of its development, and the corresponding income during the same period which the carrier would have earned in the condition in which it existed on valuation date. During the seven years preceding June 30, 1916, the date of valuation, the mileage operated by the Florida East Coast varied. To produce uniformity throughout this period, revenues and expenses per mile operated in each of the several years were obtained from the records and were multiplied by the number of miles in operation on June 30, 1916. From these figures adjusted operating revenues, expenses, and ratios were obtained. Deductions for taxes, hire of equipment, and joint-facility rents left remaining the net railway operating income for each of the seven years adjusted on the basis of the completed road. On the assumption, as heretofore explained, that only 41 per cent of the normal revenues would be earned the first year, 57 per cent the second year, and so on, the percentage for each year was applied to the adjusted operating revenues to ascertain the estimated revenue for the property reproduced new as of valuation date. Operating expenses were estimated by applying an operating ratio to the resultant revenues, bearing the same relation to the actual operating ratios of the carrier, adjusted to the mileage on valuation date, as the average of the actual operating ratios of the new lines used in the study bore to the ratios of the old lines in each of the seven years. The net railway operating income of the reproduced property was then calculated for each year and the dif-

ference between that amount and the adjusted income of the carrier was considered to be the development cost. Interest at 6 per cent was computed on the differences and compounded annually. The difference between the income of the railroad as estimated for each of the seven years on the basis of the mileage in operation on valuation date and the income estimated on the percentages of the seventh year's revenues under operating ratios obtained in the manner described aggregated from 1910 to 1915, inclusive, $5,298,816. Adding interest at 6 per cent compounded annually, aggregating $1,671,782, produced the sum of $6,970,598, which the carrier claims as its cost of development.

We have already had occasion to pass upon claims similar in principle to the above. *Texas Midland Railroad, . . . Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I. C. C., 645, and *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I. C. C., 463. In the latter case we said:

The carrier introduced a large amount of testimony and an exhibit in an attempt to show that the cost of developing the property and the business of the carrier to the point of time when, at about valuation date, it became a profit-earning carrier, amounted to approximately $14,000,000. The carrier's theory was that the cost of development of its business and property was reflected by the sum of deficits sustained from operations for the years during which it operated prior to and including June 30, 1914, the deficits being determined by ascertaining the amount by which the carrier's annual railway operating income failed to equal 6 per cent of the average investment of the carrier in property devoted to the public service. In considering the effect of deficits from operations upon the carrier's property value in the *Texas Midland case*, we said, page 71:

"* * * However, the owners of the Texas Midland have not received a fair return on their investment in this property. The operation of the road, as shown in Exhibit C and other data in Appendix 2 hereto, has resulted in frequent deficits. These deficits are not elements of value, but they are pertinent facts to be given consideration in a proper proceeding."

We are unable to sustain the carrier's contention that the method employed is the correct one for determining cost of developing its property and its business, and we are also unable to subscribe to the view that, even if the method were acceptable, the results derived from its use would justify the inclusion in the value of the carrier's property of the amount claimed as the cost of development, or as going-concern value. This method was disapproved, and the contention that cost of development should be included in the value of the public utility's property for rate mak-

ing purposes was rejected, by the Supreme Court in its recent decision in the case of *Galveston Electric Company* v. *Galveston*, 258 U. S. 388 * * *.

We deem it unnecessary to discuss the carrier's claim in this respect further. Not only are we unable to include development cost in the valuation but we are also unable to ascertain a separate amount to be allowed for going value.

KEY WEST EXTENSION

The extension from Homestead to Key West was constructed to enable the carrier to reach a point which combined the advantages of a good harbor and favorable location with respect to Gulf of Mexico, Central American, South American, and West Indian traffic. Freight is transferred between Key West and Havana in freight cars placed on ocean-going steamers, enabling a large volume of through traffic to be handled between the mainland of continental North America and Cuba without the expense, inconvenience, and risk of loading and unloading at seaports. The extension is thus a vital link in a system furnishing the entire country with rail connection with Cuba, a service not performed by any other road.

The extension is over 128 miles long, the first 14 miles south of Homestead crossing swamps to the point where it leaves the mainland, the remaining 114 miles following the arc of the Florida Keys to Key West. The keys, a low-lying chain of islands flanked by coral reefs, are generally long and narrow in shape with intervening channels and inlets which are crossed at great expense. Bridges span the channels and shallow water from key to key so that more than 13 per cent of the length is over bridges constructed at a cost, as reflected in the estimates of reproduction new, of approximately $75,000 a mile, or a total of $9,573,806. The average grading per mile is 72,500 cubic yards, practically all of which is embankment; the total reproduction new of grading is $9,593,387.

The construction of a property of this character is without precedent in railroad history. For that reason and because it was built during the years immediately preceding date of valuation and our engineers found no evidence of extravagance or wastefulness, the original cost of construction was considered the most reliable basis for estimating cost of reproduction and was very largely followed.

The original cost, including land and excluding certain amounts for unapplied construction, materials, and supplies, and a credit for revenues and expenses during construction detailed elsewhere in this report, was $27,127,205, or about $212,000 a mile. While undoubtedly high, this cost and the wisdom of the venture stand unchallenged upon the record, notwithstanding the full opportunity afforded to the public and any interested parties to protest any possible inequity resulting from its consideration, undiminished in amount, as one of the elements upon which final value for rate-making purposes would be predicated. The extension was put in operation to Key West in January, 1912. For the five years ending June 30, 1911, the net income of the carrier was $285,167.25. For the next five years it was $1,304,074.25, or an increase of $1,018,907. The influence of the operation of the extension in producing this increase does not clearly appear, but at least it failed to cause a shrinkage in net revenues. The ability of the carrier by reason of the existence of the extension to handle rail movements from Jacksonville to Key West affords it a large amount of through traffic providing a haul over the entire main line of the system. As noted elsewhere in this report, the carrier earned a net railway operating income in the year ended on date of valuation equal to a return in excess of 5.75 per cent upon the value herein found.

WORKING CAPITAL—MATERIALS AND SUPPLIES

The amount assigned as working capital and included in the final single sum value stated in the tentative valuation is $1,431,947, composed of $838,372 cash and $593,575 value of materials and supplies on hand on valuation date. This sum is 35 per cent of the carrier's operating expenses for the year ended on valuation date and 40 per cent of the average operating expenses for the five years preceding that date, and is, in our opinion, substantially in excess of the carrier's normal requirements. Our experience with the actual operating needs of individual carriers has thus far indicated that as a rule the requisite amount of working capital for carrier purposes is substantially less than 20 per cent of annual operating expenses, and in some cases is as low as 6 per cent. . . .

Taking into account the foregoing considerations, and in addition, the extent of the carrier's property, the average cash balance and value of materials and supplies over a period of years preceding

valuation date, the fact that construction was in progress during the larger part of this period and materials and supplies were used in connection with both construction and operation, and the average operating revenues and expenses during the same period, we are of opinion that the sum of $700,000, which is equal to 17.5 per cent of the operating expense for the year ended on valuation date would suffice to meet all ordinary requirements for working capital. This sum will be substituted for that stated in the tentative valuation and the final value will be modified accordingly. The excess of $731,947 of the cash and materials and supplies on hand on valuation date over the amount here found necessary for working capital is considered for purposes of this valuation as noncarrier property.

SUMMARY

The gravamen of the carrier's protest is that we have failed to give consideration to values other than those of physical property, and have therefore understated the true value. On the contrary we have appraised the plant as it was on valuation date, organized, assembled, and in successful operation, and have endeavored to give due weight to all values of an intangible nature which inhere in its property, even though we have been unable to assign definite money values to them.

We have reiterated in *Atlanta, Birmingham & Atlantic R. R. Co.* and *San Pedro, Los Angeles & Salt Lake R. R. Co.*, that we are not, and can not be, bound to a mere formula in finding and fixing a value for rate-making purposes, but that such a determination is reached by the exercise of a reasonable judgment having its basis in a consideration of the relevant facts. Where the duty of finding and fixing value reposes in a number of individuals, they may reach conclusions in which all are agreed, although each may give different weights to the various factors, and although they reach their individual conclusions by materially different processes. It is, therefore, not at all times possible for a commission to analyze its individual and composite processes of determination of value. It is, however, possible in this case to summarize, without undue elaboration, factors given consideration in determining the final value. Attention may properly be called to the fact that often there is not available as complete a record as is before us in this instance. Such matching up of figures as has been made in this summary results in coincidences in this case which in another might be

divergencies without impairing the substantial soundness of the valuation made in either case.

The carrier's books record an investment of $48,207,858.63 in carrier property. When there are excluded charges that, under our accounting classification, go to other accounts, the investment as restated in detail in Appendix 2 stands at $45,185,902 as of date of valuation. Deducting $1,709,160, the recorded cost of carrier lands, we have $43,476,742 as the investment in property other than land. The reproduction-new cost of the same property is $43,515,318. This reproduction study, therefore, provides so close a check on the investment statement as to give assurance of approximate accuracy. The known original cost of certain segments of the property also closely coincides with investment and with reproduction-new cost. The allied Terminal Company, the final value of which is found and fixed herein, affords a similar comparison. The investment in and original cost of this property are both placed at $603,502.87, of which $340,012.35 represents the original cost of land, leaving $263,490.52 for the remaining property. The reproduction-new study check produces a cost of $298,230 for the property other than land.

In this case . . . original cost of the entire property of the carrier could not be ascertained, but the original cost of an important segment of the property, the Key West extension, is in the record . . . $27,984,675. This includes $1,275,620 for certain expenses connected with land, $98,315 for unapplied construction, materials, and supplies, and a credit of $56,202 for revenues and expenses during construction, items not taken into account in the engineering report on reproduction. Elimination of these items brings the cost of the Key West extension to $26,666,942, which may be compared with the cost of reproduction new of $26,666,940. This latter figure is the cost of reproduction new of the Key West extension included in the original cost figures stated above, but does not include an item of $614,782 for the cost of reproduction new of floating equipment, not set out in the detail of original cost of the Key West extension.

Turning to equipment, including floating equipment, we find another illustration of the close check of original cost by our cost of reproduction new. The cost of the carrier's equipment is stated in the records to be $5,039,854. Of this amount all but $82,312 has been verified by examination of the accounts. We find that to

reproduce the same equipment new on valuation date would cost $4,999,222.

The Key West extension, together with the equipment owned by the carrier, accounts for $33,024,529 original cost in the $45,185,902 of investment and for $31,666,162 of the $43,515,318 cost of reproduction new. As we have already pointed out, the amount of the investment in the entire common-carrier property, less that pertaining to carrier land, closely approximates the cost of reproduction new. While we are unable to find original cost of each item of property of the carrier, other than land, $43,500,000 may be said to approximate closely the original cost of creating and improving the property as a whole. The records reveal that the original cost of carrier lands was $1,709,160, raising the total of physical properties and lands to $45,209,160. There is included in this total $60,914 of donations made in the construction of industrial switches, but no value for donated lands. It is possible that some part of the $497,124 expenses attaching to all donated lands should be added to cost of carrier lands.

In our reproduction studies we have applied unit prices based on a 5-year and, for some items, 10-year span, ended June 30, 1914. The methods employed in making these studies . . . are intended to afford an index of the cost of producing the property during the short period of years prior to June 30, 1914. All necessary overhead charges are included. The grading quantities have been obtained from the measurement of the volume of the roadbed as it existed on date of valuation, which included not only materials moved during original construction but those taken away from the cuts by the action of the elements. This is equivalent to making an allowance for appreciation in the cost of reproduction new. In fixing a unit price for the material in the fills the fact that an excess over the present measured volume would have to be handled to provide for shrinkage and settlement due to lapse of time, the action of the elements, or other causes, was given consideration, thus further allowing in the cost of reproduction new another element of appreciation. No depreciation of any character was assessed against the grading in the roadbed. This treatment of the subject involves a minimum of speculation and allows carriers that appreciation to which a definite cost can be assigned.

Thus far in this summary we have not referred to the cost of reproduction less depreciation arrived at in the same synthetic way

as the cost of reproduction new and resulting in a total on valuation date for property other than land of $38,569,822. The value of the lands on that date, determined in conformity with the method described in the *Texas Midland case* . . . was $4,406,448.[1] This amount, added to the depreciated value of other property, produces the sum of $42,976,270.

Valuation is not a mere mathematical restatement of original costs, investment, and estimated reproduction new or less deprecition of physical property other than land, with present land values added thereto. Our tentative valuation of the carrier took into consideration the fact that it was on valuation date a vitalized, organized, going railroad. The railroad property, separated from working capital then on hand, was given a value of $45,500,000. This was the value found for a railroad with organized forces and attached business, an established agency of public service whose existence seems fully justified and the record of whose organization and construction is impressive in the matter of risk assumed and services rendered. The railroad provides rail transportation facilities to the east coast of Florida and has been the principal factor in the development of that part of the country. To it is to be attributed in a large measure the increases of values which have there occurred. It extends beyond the mainland of Florida and carries the national rail system to Key West and, by ferries and terminals, makes possible the transportation of freight not only between Key West and all parts of the United States, but, in unbroken carloads, between Cuba and the United States.

The carrier not only serves an important part in supplying the transportation needs of the country, but its financial record indicates a well-conceived and established business. From 1909 to 1916, inclusive, its operations were conducted at a profit. No dividends were paid, and the surplus from operations was credited to profit and loss. During the year ended June 30, 1916, the net railway operating income, including therein the debits and credits from equipment and joint-facilities rents, amounted to $2,778,322, or sufficient to pay a return of 5.75 per cent on a capital of $48,-319,000. Its unmatured funded debt amounted to $37,300,000, which, with $10,000,000 par value of capital stock outstanding on June 30,1916, produced a total of $47,300,000. Its net railway

[1] The method of valuing carrier lands used by the Commission is discussed at length in Homer B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission*, pp. 52–72, and in Vanderblue and Burgess, pp. 344–346.—Ed.

operating income averaged over the five, four, three, and two year periods preceding valuation date produced sums sufficient to pay a return of 5.75 per cent on amounts varying from $27,001,000 for the five-year period to $39,720,000 for the two-year period. The substantial higher earning capacity during the year ended June 30, 1916, has already been noted.

The market value of bonds and stock can not, in this instance, be resorted to as affording enlightenment on the value of the property. On date of valuation all except nine shares, par value $900, of the 100,000 shares, par value $10,000,000, of the capital stock outstanding were owned by the estate of Henry M. Flagler and Mrs. Mary Lilly Flagler, the nine shares being held in the names of the directors. A majority of the bonds also were held by the Flagler estate. The road was then emerging from a period of construction and extensions. It had been financed as well as constructed almost entirely by Henry M. Flagler, and is stamped with some aspects of a personal venture.

The law requires that we report the original cost of all lands, rights of way, and terminals ascertained as of time of dedication to public use, and the present value of the same. . . . In the investment and original cost statements hereinbefore analyzed no amount is included to cover value of donated lands and only $60,914.64 representing donations. These were made on account of construction of industrial tracks. The land aids were extensive, however, including 611,447.65 acres of land grants. The carrier and its predecessors disposed of 604,512.90 acres of these lands for $701,750.54. In addition to these, the carrier received 222,271.76 acres designated as donations, and of these lands sold 216,593.03 acres for $494,736.80. There were attaching to both classes of donated lands $497,023.97 of expenditures. Other minor parcels of land are listed in Appendix 2 for which the considerations were nominal or which represent streets occupied by the carrier. The carrier also, free of consideration, received 333 1/3 shares of the capital stock of the Jacksonville Terminal Company. The value on date of valuation of all donated lands then owned by the carrier is $2,289,199.93, of which $2,169,576.52 represents value of carrier lands and $119,663.41 value of noncarrier lands.

No concessions or allowances appear to have been made by the carrier on account of its having acquired lands through land grants.

We find no values or elements of value other than those mentioned above.

Upon consideration of such matters as we have here summarized, as well as in more detailed disposal of the various specific protests to the tentative valuation, we reach the conclusion and find that the value for rate-making purposes of the property of the carrier owned and used for purposes of a common carrier, including $700,000 for working capital, is $46,200,000, and of the property used but not owned $764,196, and that the value for rate-making purposes of the property of the Terminal Company is $1,300,000.

The act also requires us to value investment in stocks and bonds of other companies, and notes of such companies or individuals. . . . Such noncarrier assets do not affect the value for rate-making purposes. . . .

An order will be entered in accordance with our findings.

HALL, *Chairman*, concurring:

In reaching with the majority the conclusions expressed in this report as to value for rate-making purposes on valuation date it is appropriate to say that the treatment of other values or elements of value seems to me inadequate and of "working capital—materials and supplies" erroneous.

AITCHISON, *Commissioner*, concurring generally:

I dissent from the designation as noncarrier property of the greater portion of the cash and materials and supplies on hand as not warranted by the record.

EASTMAN, *Commissioner*, dissenting:

In my separate statement, in the *San Pedro case*, 75 I. C. C., 463, 523–567, I expressed the view that so-called value for rate-making purposes should be based on the amount invested honestly and with a reasonable degree of providence in the existing property. To determine this amount it is necessary to know, as nearly as may be, what the property should have cost. The analysis of this subject in the majority report is incomplete, but it is possible to arrive at an approximation. Upon this point the conclusion of the majority with respect to the Florida East Coast is as follows:

> While we are unable to find original cost of each item of property of the carrier, other than land, $43,500,000 may be said to approximate closely the original cost of creating and improving the property as a whole. The records reveal that the original cost of carrier lands was $1,709,160, raising the total of physical properties and lands to $45,209,160.

In the case of the allied Terminal Company, the corresponding finding is:

The investment in and original cost of this property are both placed at $603,502.87, of which $340,012.35 represents the original cost of land, leaving $263,490.52 for the remaining property.

I am willing to accept these approximations as reasonably close. Adding $700,000 for cash working capital and materials and supplies, the total becomes $45,909,160, in the case of the Florida East Coast, as compared with $46,200,000 fixed by the majority as the value for rate-making purposes, and, in the case of the Terminal Company, $603,503 as compared with $1,300,000. It is the existing property which is being valued, however, and the majority estimate the losses through depreciation as $4,945,496 for the Florida East Coast and $30,723 for the Terminal Company. Deducting from the totals above given but one-half of these sums, for the reasons indicated in my opinion in the *San Pedro case*, I arrive at $42,936,412, in the case of the Florida East Coast, and $588,142 in the case of the Terminal Company, as liberal approximations of the reasonable investment remaining in the property as of June 30, 1916. In my opinion, the respective rate bases as of that date should not exceed these figures.

Some question has been raised, not I think as to the honesty, but rather as to the prudence of the investment in the Key West extension of the Florida East Coast. As indicated in my separate expression in the *Atlanta, Birmingham & Atlantic case*, 75 I. C. C., 645, 676, we should be slow to take action which will deprive investors of an *opportunity* to earn a return upon money which has been honestly expended in the construction of a railroad. Every investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown. So far as I am aware, neither the people of Florida nor the constituted authorities of that State have questioned the character of the investment in the Key West extension, which furnishes the only rail link between this country and Cuba; and if that investment was so wasteful and extravagant that the chance of earning a return upon the entire amount should be denied, the present record furnishes no basis for such a finding.

I am inclined to believe that the thought that there should be, perhaps, such a denial is born of the provisions of section 15a of the interstate commerce act. Under that section any value for

rate-making purposes that we fix for the Key West extension becomes a part of the aggregate value of carrier property upon which freight and passenger rates within southern territory generally must be based. If traffic upon the extension is insufficient to produce the stipulated return, then, under this rule of rate-making, an amount equal to that return must be derived from other traffic within the territory, even if such amount in no way accrues to the benefit of the Florida East Coast. But the provisions of section 15a are wholly statutory and may be repealed or modified at any time. Quoting from *Dayton-Goose Creek Ry. Co.* v. *United States,* decided by the United States Supreme Court on January 7, 1924:

> The carrier owning and operating a railroad, however strong financially, however economical in its facilities or favorably situated as to traffic, is not entitled as of constitutional right to more than a fair net operating income upon the value of its properties which are being devoted to transportation.

The stronger carriers are not entitled as of constitutional right to excess income which will offset the shortages of weaker roads, in order that all the carriers, strong and weak, in a given territory may earn an *aggregate* net operating income equal to a fair return upon the *aggregate* value of their railway properties. Constitutionally there is nothing which stands in the way of public regulation which would reduce the rates of each prosperous carrier down to a point permitting no more than a fair net operating income upon the value of its property, allowing the weaker carriers at the same time to charge such higher rates as they may be able in competition to maintain. As the court states in the case above cited, "Classification of railways in the matter of adjustment of rates has been sustained in numerous cases."

It was plainly the intent of Congress that, having fixed rates for a group under the provisions of section 15a, we should do what we can to redistribute earnings so that the poor as well as the rich companies may earn a fair return. Quoting again from the recent *Dayton-Goose Creek case:*

> In the *New England Divisions Case,* 261 U. S., 184, it was held that under Section 418 the Commission in making division of joint rates between groups of carriers might in the public interest consult the financial needs of a weaker group in order to maintain it in effective operation, as part of an adequate transportation system, and give it a greater share of such rates if the share of the other group was adequate to avoid a confiscatory result.

But if it should prove impossible with the means at our command to redistribute earnings so that a carrier like the Atlanta, Birmingham & Atlantic will earn a fair return upon its value for rate-making purposes, or so that the Florida East Coast will earn such a return upon its Key West extension, it is clear that there are no constitutional inhibitions which prevent the repeal or amendment of section 15a. And in any event the results which it is feared may flow from the provisions of a particular statute have no bearing upon our duty in this proceeding.

POTTER, *Commissioner,* dissenting:

I am not able to concur in the majority report. I think it irregular to the point of illegality in that it does not contain a proper statement of principles, analysis, and method, and does not explain how and why its conclusions are reached. It encourages some inferences but expressly disclaims the process indicated. The report also exhibits certain specific erroneous conceptions which must have affected the figure of final value.

The report gives information as to original cost, reproduction cost, reproduction cost less depreciation, earnings down to valuation date, the amount of securities outstanding, and points out that information as to selling prices is not available. It states that "we have appraised the plant as it was on valuation date, organized, assembled, and in successful operation, and have endeavored to give due weight to all values of an intangible nature which inhere in its property, even though we have been unable to assign definite money values to them." It disclaims resorting to formula and states that the "determination is reached by the exercise of a reasonable judgment having its basis in a consideration of the relevant facts."

Except for the disclaimer of use of formula and of having given any particular weight to any particular factors, it would be quite natural to conclude that $46,200,000 was arrived at as the final value by adding an allowance of $700,000 for working capital to $45,500,000 found as the value of the other property, the $45,500,000 being arrived at as follows:

Cost of reproduction new of physical properties....	$43,515,318
Cost of reproduction less depreciation............	38,569,822
Present value of lands..........................	4,406,448
Total..................................	42,976,270

The final figure of $45,500,000 represents an addition of $2,523,730 to the figure of $42,976,270. This addition is 5.8 per cent of $42,976,270. It appears that in practically all of our tentative valuations a figure which averages about 5 per cent has been arbitrarily added to the figure representing reproduction cost less depreciation, plus value of lands and the resulting figure has been named as representing final value. A list of 330 carriers as to which we have found tentative final value, shows that the figures given as cost of reproduction less depreciation, plus value of lands, plus 5 per cent, correspond so closely with the tentative final values found, less cash and material and supplies, as to lead to the conclusion that the former figures were taken as the basis for arriving at the latter. The aggregate of the items for these carriers showing their cost of reproduction less depreciation, plus present value of lands, plus 5 per cent, is $2,955,206,577. The aggregate of the tentative final values less cash and material and supplies is $2,957,504,106. The difference is only one-thirteenth of 1 per cent in excess of the 5 per cent arbitrary. It appears that in many cases the 5 per cent arbitrary coincides very closely with 50 per cent of the depreciation found. Just what is the significance of this coincidence does not appear. Why the arbitrary which averages approximately 5 per cent was adopted has never been explained. On review it will make more difficult the solution of the puzzle of what we do and why we do it. The report in this case disclaims resort to this formula so that explanation of how the figure of final value is arrived at is not available.

The report shows that figures as to original cost agree closely with those of estimated reproduction cost. It finds that the carrier is essential and efficient, and shows that its construction was justified on the basis of original cost, and would be justified on the basis of estimated reproduction cost. There is, therefore, warrant for basing a finding of value on those figures. Analysis, principles, and rules could be stated. The case is peculiarly appropriate for such treatment and explanation of reasons. Notwithstanding this fact, the report emphatically repudiates any particular figure as having any particular significance. This is unfortunate because if the mind were to run in this case as the figures suggest, a precedent would be established that would be helpful in other cases. For instance, the same method, analysis, and reasoning would have exposed the lack of soundness in our finding in the case of the Atlanta, Birmingham & Atlantic. Apparently this

fact is recognized by the majority report. To the end that no conclusion shall be drawn from this case that can be applied to others, the report points out that views of commissioners may differ as to reasons, but coincide as to conclusions, and says:

> It is, therefore, not at all times possible for a commission to analyze its individual and composite processes of determination of value. It is, however, possible in this case to summarize, without undue elaboration, factors given consideration in determining the final value. Attention may properly be called to the fact that often there is not available as complete a record as is before us in this instance. Such matching up of figures as has been made in this summary results in coincidences in this case which in another might be divergencies without impairing the substantial soundness of the valuation made in either case.

The report, therefore, leaves a reader entirely in the dark as to how its conclusions are reached. This is basic error which should lead to condemnation in its entirety. It is incumbent on us to give sound reasons for what we do. We must apply principles and they must be applied consistently in all cases. We act arbitrarily until we announce the rules and principles which we apply. To state relation of original cost to reproduction cost is not merely an idle "matching up of figures." The results are not inconsequential "coincidences" or divergencies." We must and necessarily do either deny or accord influence to such figures in every case. We should show how we use them in each case. We are not at liberty to accord them the same influence in all cases. We must be influenced by the results of construction expenditure rather than by amount of such expenditure. The result of a unit of expenditure in the construction of an efficient carrier that is essential and renders vast public service is of far greater value than a similar result for a nonessential, inefficient carrier which renders less important service. Depending upon the conditions and characteristics of different carriers some are entitled to be valued at a figure that would protect original cost. Values of some are below that figure and of others above. It is inconceivable that all the railroads should so correspond in character and merit that the values of all could, to the extent our reports indicate, be based on expenditure. If, in this case, original cost, reproduction cost, reproduction cost less depreciation, value of lands, cost of lands, development cost, amount of outstanding securities, earnings, efficiency, public service, and public need, had each been specifically dealt

with as a factor affecting value, and if that method were determined to be adopted for all cases, we would have taken a long step toward sound practice. Such a method applied to each case would show the weight to be assigned to different elements which would vary in different cases. The final conclusions would, therefore, vary and show inevitably what everyone knows, that some properties are of far greater value than others showing the same or greater original cost, reproduction cost, reproduction cost less depreciation, plus value of lands, and plus the arbitrary.

In our report in *Petition of National Conference on Valuation*, 84 I. C. C., 9, I indicated how, in my opinion, the carriers should be classified and their values determined. Applying the principles there stated I think that in the case of the A., B. & A. the value of the accomplishment for a given unit of expenditure would be much less than the amount of the unit. In the case now before us, it is my view that actual expenditure should be adopted as the measure of value. I would apply this measure to lands as well as to other property. The carrier is essential and efficient. It renders indispensable public service. Original cost harmonizes with reproduction cost. Its record of earnings indicates sound financial enterprise at a value which harmonizes with its cost. On the other hand, it has not shown any special efficiency or merit indicating higher value. Though meritorious it has not demonstrated any special value above the amount invested in it. Under these circumstances I think it appropriate to apply the prudent-investment rule of protection of the expenditure in connection with it.

There should be included in expenditure the amount necessary to carry the property during its development period. Substantial expenditure was required to carry it to the time when it reached maturity. It was in the public interest that it be so carried. For these reasons we should and could conclude that it has a value corresponding with actual investment, plus carrying charges. A conclusion thus arrived at would carry convincing weight. The same test applied to the A., B. & A. would have shown less merit and less value per unit of expenditure. Other carriers, more essential and efficient, and rendering a higher degree of public service, which have enjoyed or are likely to enjoy relatively higher earnings because of their inherent merit, should be accorded a value in excess of original cost, such value according with or being above or below estimated reproduction cost. To apply this method in all cases would make it easy to review our

work, test our reasons, and determine the correctness of our conclusions.

Soundness can be attained and justice done only when we fully explain our method of dealing with the various factors as they differ in the different cases. To ignore differences, coincidences, and divergencies, and treat all alike will result not only in "impairing the substantial soundness of the valuation made" but will render our valuations useless. The so-called matching up of figures does not result in coïncidences. It will show divergencies, but those divergencies when considered in the light of relative efficiencies and public service are the things we want to know, for they determine value and relative value and exhibit the reasons for results. They do not impair the soundness of the valuation made. They control and determine value. Soundness of valuation is impossible when such divergencies are disregarded. Correct conclusion as to value can not be arrived at without thus considering the factors. To thus consider them is the requirement of law and reason.

Our most important duty is to learn what the law is, and how to arrive at value. We do not know. The courts must tell us. Valuation is a judicial function. Values must ultimately be determined by what the courts think, not by what we think. "What would the courts say" is the question we must constantly ask ourselves. We should facilitate getting the important questions involved into the courts with the greatest possible expedition and in a way to point out the difficulties and perplexities. We are not doing this. We are doing the opposite. We are allowing our reports to take that form which makes review most difficult, if not impossible. This case naturally gives opportunities to bring up nearly every important question involved in valuation. We reject them all. We could specifically refer to every rule and principle we apply and give our views and explain why we do what we do. If we did that the courts would tell us where we are right and where we are wrong. The whole atmosphere would clear. We, the carriers, the Congress, and the public would know where we stand and what we are doing. We could then go ahead in sound fashion and make real progress. To go ahead as now leaving clouds of mystery over all we do, telling interested parties to take our conclusions and ask no question, is unworthy performance of the trust reposed in us. It gets us nowhere. It leaves wasteful uncertainty; makes unnecessary work, trouble, and worry for all concerned.

Proper analysis of method would perhaps show accord at certain

points and thus the field of controversy would be reduced and burdens lessened. Failure to state methods and analysis so as to focus testing thought is wasteful because it elaborates unduly the study required in order to determine whether one is in accord with the final conclusion. It is not possible for the members of the commission generally to examine the record in these valuation cases. Under such circumstances, unless our reports clearly set forth and analyze the methods used in building conclusions, and show the treatment of the different elements, varying in different cases, that influence value, so that the report may be convincing in and of itself, even we, whose work the report is, can not have satisfactory reason for our action. Our method is peculiarly unfair to the courts, for it throws burdens on them that properly are ours. If we would decide a few cases so as to show our interpretation of the law and make detection of our error possible, the courts could straighten us out, and we could go ahead and do our job in a satisfactory manner in most cases. It would not be necessary to take many of our reports into the courts. As we now are doing our work, it will be necessary, as I see it, to take practically all of our reports into the courts. I see no escape from their being compelled to do all our work over again. This will be the natural consequence of giving conclusions and withholding reasons and arriving at aggregate figures without showing how we reach them. In justifying our valuations in court, it seemingly will be necessary to build up each case as completely as we have with our own staff to arrive at our findings. We will be required to organize extensive forces for court work, and litter courts with our records and data and the testimony which we have taken. The expense and delay will be frightful. I apprehend that the courts will send the cases to masters and that in the end they will value the carriers. In that event many millions that we have expended and required the carriers to expend, and much time and trouble will have gone to waste. Correct practices now would avoid the calamity for which we are headed.

I do not share at all the notion that it is not possible for a commission of 11 men to announce principles. Most of the uncertainties that exist would be cleared away by finding the answers to a dozen questions or so, which would involve fundamental principles. The commission could decide such specific questions and thereafter adopt in all cases the conclusions thus arrived at. These questions being answered by the commission in a specific case, our

positions would be known. The courts could then pass upon those questions and our answers to them, and thus furnish us guides with which we could perform our task. Questions thus raised could be considered by the courts readily without throwing on them the burden of trying all the cases in their entirety as would seem to be necessary until the fog for which we are responsible is cleared away.

We should take a position squarely upon the question as to when and under what circumstances carriers are to be valued at original cost or less, or at reproduction cost, or more. In particular we should clear up the uncertainty as to the influence accorded to reproduction cost. We think that predominating influence is not given to reproduction cost. We may be mistaken. A careful study of all our reports to date may be regarded as indicating otherwise. We are constantly referring to our tentative reports and using their findings in determining the amount of allowable stock issues and otherwise in our work. . . .

We should take position squarely on questions as to the treatment of development cost, depreciation, and appreciation. We should announce whether, in our view, in valuing a property as a whole, deduction should be made from cost as a measure of value of an amount representing depreciation supposed to have taken place in particular material, and whether such depreciation is to be considered as lost in a finding of value although the carrier is essential and efficient. We should take a position squarely regarding good will, and how and to what extent it should be valued. We should make determinations as to land value so as to bring questions to the front and have determined the influence of land value in determining the value of a property as a whole. We are to value the property as a going concern. At the same time we are to report the values of lands. We have been told by the court how to value lands. Are the land values so to be arrived at to be taken in all cases as specific figures to be added to the value of the other property; or may lands in different cases, in connection with the property as a whole, be accorded values more or less? Adjoining lands may be shown to have particular values. When used by a carrier as a part of its property as a whole may they not have a special or different value more or less? Does the statute requiring land values to be found require that those values be used without regard to their real value for carrier purposes, or is the requirement of the statute designed primarily to force expla-

nation of what we do? Although particular pieces of lands may have particular values, is their aggregate as a long strip used as right of way of value greater or less than the aggregate values of the parts? A right of way entering a city may be through land of little value. The right of way as desirable entry to the city may be of enormous value. Is the value of a property influenced by its strategic position, indicating wisdom and foresight of location? May the accomplishment of an expenditure on an efficient carrier wisely conceived, rendering vast public service, be valued at a higher figure than a similar expenditure on an inefficient carrier, poorly conceived, capable of rendering less important public service? These and others are questions upon which we could and should take definite position.

Some of the specific erroneous conceptions which must have influenced the figure of final value, are as follows:

The carrier urges that in considering cost, investment, or other elements of value, it should have credit for approximately $7,000,000 for carrying the property during the development period and plausible reason for accepting this figure is set forth in the report. How much of an allowance is made by the report for the fact that the property was carried during its early period in anticipation of the recognition of values which only the future could disclose does not appear. If the arbitrary of 5.8 per cent is for this purpose, there is nothing to indicate whether it is too much or too little, or the basis on which we arrive at it, or the principle we apply to this case that can be applied to others. We should take position on these questions. We should accept the carrier's method or state another. In my judgment the allowance should be a fair interest return per annum during the development period upon the investment, less the earnings of the property in the meantime. However the figure is to be arrived at, we should decide definitely what allowance should be made, and upon what basis it should be computed. It is well known that a reasonable period is required for development and carriers are not expected to earn a fair return upon the investment from the outset. The carrying burden is part of the investment in the property and should be protected. Development cost constitutes essential expenditure as much as construction cost. Everybody knows that such an item must be provided for in connection with every new property. The property had to be carried during the development period. Those who carried it are entitled as a matter of

common honesty to have this carrying expenditure protected. To refuse to do so would be confiscation. The report gives the impression that in some undisclosed manner development cost was considered in arriving at the final value, but the report does not show how it was considered or with what result. With such treatment erroneous view of the law would have no effect. No one would ever know whether we really did or did not make any allowance for development cost. The parties interested and the public are entitled to know how we treat the subject, what we do about development cost, and what we think the law is, and they are entitled to an opportunity to have the courts pass upon our method. The treatment in the majority report would make review difficult if not impossible. Stocks represent the values which the future is expected to develop and demonstrate. It is obvious in this case that the figure of final value is lower than it otherwise would be by the extent to which credit for development cost or good will was denied.

The figure allowed for working capital I think is inadequate. $700,000 is less than the aggregate of cash and material and supplies on hand during any one year. The average for the years 1912 to 1916, inclusive, is $1,063,025. There is warrant for accepting this figure. To use any other figure seems arbitrary.

It appears obvious that the figure of final value has been made less than it otherwise would be by the deduction of $4,945,496, being the amount by which the property is said to have depreciated. The amount would be required to reproduce the property, and should be considered as in the original investment. The property has been well maintained and as a going entity has not depreciated. It is not conceivable that a sane person would ever build a railway if he knew that a substantial part of his investment would be considered lost through depreciation and that he would not be permitted to have a return upon it. The law has no such unconscionable purpose. The report praises the carrier as essential and efficient. To deduct depreciation where such depreciation has not been taken care of out of income from the value which other figures suggest, is arbitrary, inequitable, and illegal confiscation of property.

The report states that since the decision of the Supreme Court in *Knoxville* v. *Water Company*, 212 U. S., 1, "courts and commissions have accepted, as a settled practice in valuation proceedings, the deduction from reproduction new of the depreciation." It

says that the Congress in its mandate "has required the Commission to report cost of reproduction new and also cost less depreciation." I can not see that the *Knoxville case* is applicable to the case before us. Nor can I agree that the mandate under which we act requires us to report depreciation when as here there is no depreciation in fact which affects value.

The report discloses another error which is fundamental. It does not do what the statute tells us to do. It says that "We have appraised the plant as it was on valuation date." The valuation date was June 30, 1916, more than seven years ago. Evidence as to subsequent conditions would throw light as to the value on valuation date, but it is disregarded. How values demonstrated later shall be determined is not shown. The whole basis for arriving at values throughout the world has changed since 1916. A valuation as of 1916 could not in the nature of the case be sufficient, fair, or legal for the purposes for which we are valuing the railway. It can not be a valid and final valuation and be entitled to the presumptions and effects of a final valuation and can not have efficacy in law. We should withhold a so-called final valuation until we can bring it down to date. To do so in this case would give the carrier the benefit of a showing of public service represented by gross earnings of $13,579,109 in 1921 as compared with gross earnings of $6,374,933 for the year 1915–1916. A consideration of earnings and public service should lead to a very different final figure. The question is not what was the value of this property in 1916, but as to its value at the present time or at a time when there prevailed conditions substantially similar to those at present.

The report in this case also discloses the error made in prior cases of not determining value which, when determined, must be used for rate-making purposes because it is value, but arbitrarily states a figure which without warrant of law we set up as the figure to be used as a basis for rate making.

We have great responsibility in this valuation work. It is a task that is designed to be upbuilding, to promote fairness, and create that confidence which is essential to the solution of the so-called railroad problem, and provide efficient transportation. The railways, considered in their relation to other enterprises, are probably first in importance. Agriculture and manufacture would be helpless without them. They need from 600 to 800 millions of dollars of new money each year for additions and better-

ments. They must have it if the country is to continue to develop and enjoy prosperity. It must be obtained from private sources. Private investors must be looked to. They must be individuals and institutions, such as insurance companies and banks which invest their money on a business basis. The new money must come in the main from the present investors in our railroads. There are about 50,000,000 of them at the present time, counting, of course, those whose moneys are invested through insurance companies and savings banks which they own. If they are to continue to invest their moneys in railroads, they must be convinced that fair returns will be allowed to the carriers and that their present investments will not be confiscated by Government agencies in the processes of valuation. Obligation to observe good faith and protect security values, and the fact that stocks represent intangibles and indicate relative merit resulting from location, efficiency, and foresight, prompted the Supreme Court in *Smyth* v. *Ames* to say that in valuation work consideration must be given to the amount and selling prices of securities. A policy which threatens loss through confiscation and disturbs the confidence of security holders in the agencies of Government when dealing with their property menaces the public interest and violates the law.[1]

I am authorized to state that COMMISSIONER COX concurs in this dissent.

CAMPBELL, *Commissioner*, dissenting:

The law specifically requires the commission to ascertain and report in detail the original cost to date of each piece of property owned or used for common-carrier purposes. The majority have found the original cost of the Florida East Coast Railway only with respect to the Key West extension. Had the law been complied with and the original cost of the property as a whole been ascertained, the figure at which the final value has been placed might have been different. For this reason I withhold my assent to the findings of the majority.

I may add that I can not bring myself to believe that an expenditure of as much as $218,000 per mile of road, found to have been the average original cost per mile of the Key West extension, could have been or could be in the public interest. While that may have

[1] Further differences of opinion between the majority members of the Commission and Commissioners Potter and Eastman are developed at some length in *Kansas City Southern Railway Company*, 84 I. C. C. 113; Commissioner Potter's dissenting opinion appears at pp. 124–139, Commissioner Eastman's at pp. 140–144.—Ed.

been the original cost per mile of this portion of the Florida East Coast Railway, I doubt if it should be used as the value for rate-making purposes upon which the public will be expected to pay to the owners the fair rate of return designated by the commission.

2. The Recapture of Earnings [1]

Mr. Chief Justice Taft delivered the opinion of the Court.

The main question in this case is whether the so-called "recapture" paragraphs of the Transportation Act of 1920 . . . are constitutional.

The Dayton-Goose Creek Railway is a corporation of Texas, engaged in intrastate, interstate, and foreign commerce. Its volume of intrastate traffic exceeds that of its interstate and foreign traffic. In response to orders of the Interstate Commerce Commission, the carrier made returns for 10 months of 1920, and for the full year of 1921, reporting the value of its railroad property employed in commerce and its net revenue therefrom. It earned $21,666.24, more than 6 per cent., on the value of its property in the 10 months of 1920, and $33,766.98 excess in the 12 months of 1921. The Commission requested it to report what provision it had made for setting up a fund to preserve one half of these excesses, and to remit the other half to the Commission.

The carrier then filed the present bill, setting forth the constitutional invalidity of the recapture provisions of the act and the orders of the Commission based thereon, averring that it had no adequate remedy at law to save itself from the irreparable wrong about to be done to it by enforcement of the provisions, and praying that the defendants, the United States, the Interstate Commerce Commission, and the United States district attorney for the Eastern District of Texas, be temporarily restrained from prosecuting any civil or criminal suit to enforce the Commission's orders and that the court on final hearing make the injunction permanent. . . .

While the Dayton-Goose Creek Railway Company was the sole complainant below and is the sole appellant here, nineteen other railway companies . . . filed briefs in support of its appeal. . . .

By section 422 of the Transportation Act, there was added to

[1] *Dayton-Goose Creek Railway Company* v. *United States*, 263 U. S. 456 (January 7, 1924). See Vanderblue and Burgess, pp. 322–334, and Jones, pp. 550–551, 596. The subject-matter of this decision (which upholds the recapture of earnings) supplements these discussions, especially that in Vanderblue and Burgess at p. 332, and in Jones at p. 596.—Ed.

the existing Interstate Commerce Act, and its amendments, section 15a. The section in its second paragraph directs the Commission to establish rates which will enable the carriers, as a whole or by rate groups or territories fixed by the Commission, to receive a fair net operating return upon the property they hold in the aggregate for use in transportation. By paragraph 3 the Commission is to establish from time to time and make public, the percentage of the value of the aggregate property it regards as a fair operating return, but for 1920 and 1921 such a fair return is to be 5½ per cent., with discretion in the Commission to add one-half of 1 per cent. as a fund for adding betterments on capital account. By paragraph 4 the Commission is to fix the aggregate value of the property from time to time, using in doing so the results of its valuation of the railways as provided in section 19a of the Interstate Commerce Act so far as they are available and all the elements of value recognized by the law of the land for rate-making purposes, including so far as the Commission may deem it proper, the investment account of the railways.

Paragraph 5 declares that because it is impossible to establish uniform rates upon competitive traffic which will adequately sustain all the carriers needed to do the business, without giving some of them a net income in excess of a fair return, any carrier receiving such excess shall hold it in the manner thereafter prescribed as trustee for the United States. Paragraph 6 distributes the excess, one-half to a reserve fund to be maintained by the carrier, and the other half to a general railroad revolving fund to be maintained by the Commission. Paragraph 7 specifies the only uses to which the carrier may apply its reserve fund. They are the payment of interest on bonds and other securities, rent for leased lines, and the payment of dividends, to the extent that its operating income for the year is less that 6 per cent. When the reserve fund equals 5 per cent. of the value of the railroad property, and as long as it continues to do so, the carrier's one-half of the excess income may be used by it for any lawful purpose. Under paragraph 10, and subsequent paragraphs, the general railroad revolving fund is to be administered by the Commission in making loans to carriers to meet expenditures on capital account, to refund maturing securities originally issued on capital account and for buying equipment and facilities and leasing or selling them to carriers. . . .

The new act seeks affirmatively to build up a system of railways

prepared to handle promptly all the interstate traffic of the country. It aims to give the owners of the railways an opportunity to earn enough to maintain their properties and equipment in such a state of efficiency that they can carry well this burden. To achieve this great purpose, it puts the railroad systems of the country more completely than ever under the fostering guardianship and control of the Commission which is to supervise their issue of securities, their car supply and distribution, their joint use of terminals, their construction of new lines, their abandonment of old lines, and by a proper division of joint rates, and by fixing adequate rates for interstate commerce, and in case of discrimination, for intrastate commerce, to secure a fair return upon the properties of the carriers engaged.

It . . . is insisted here, that the power to regulate interstate commerce is limited to the fixing of reasonable rates and the prevention of those which are discriminatory, and that when these objects are attained, the power of regulation is exhausted. This is too narrow a view of the commerce clause. To regulate in the sense intended is to foster, protect and control the commerce with appropriate regard to the welfare of those who are immediately concerned, as well as the public at large, and to promote its growth and insure its safety. . . . Mr. Justice Bradley, speaking for the court in *California* v. *Pacific Railroad Company*, 127 U. S. 1, 39, said:

"The power to construct, or to authorize individuals or corporations to construct, national highways and bridges from state to state, is essential to the complete control and regulation of interstate commerce. * * * This power in former times was exerted to a very limited extent, the Cumberland or National road being the most notable instance. * * * But since, in consequence of the expansion of the country, the multiplication of its products, and the invention of railroads and locomotion by steam, land transportation has so vastly increased, a sounder consideration of the subject has prevailed and led to the conclusion that Congress has plenary power over the whole subject."

If Congress may build railroads under the commerce clause, it may certainly exert affirmative control over privately owned railroads, to see that such rairoads are equipped to perform, and do perform, the requisite public service.

Title IV of the Transportation Act, embracing sections 418 and 422, is carefully framed to achieve its expressly declared objects. Uniform rates enjoined for all shippers will tend to divide the

business in proper proportion so that when the burden is great, the railroad of each carrier will be used to its capacity. If the weaker roads were permitted to charge higher rates than their competitors, the business would seek the stronger roads with the lower rates, and congestion would follow. The directions given to the Commission in fixing uniform rates will tend to put them on a scale enabling a railroad of average efficiency among all the carriers of the section to earn the prescribed maximum return. Those who earn more must hold the excess primarily to preserve their sound economic condition and avoid wasteful expenditures and unwise dividends. Those who earn less are to be given help by credit secured through a fund made up of the other half of the excess. By the recapture clauses Congress is enabled to maintain uniform rates for all shippers and yet keep the net returns of railways, whether strong or weak, to the varying percentages which are fair respectively for them. The recapture clauses are thus the key provision of the whole plan.

Having regard to the property rights of the carriers and the interest of the shipping public, the validity of the plan depends on two propositions.

First. Rates which as a body enable all the railroads, necessary to do the business of a rate territory or section, to enjoy not more than a fair net operating income on the aggregate value of their properties therein economically and efficiently operated, are reasonable from the standpoint of the individual shipper in that section. He with every other shipper similarly situated in the same section is vitally interested in having a system which can do all the business offered. If there is congestion, he suffers with the rest. He may, therefore, properly be required in the rates he pays to share with all other shippers of the same section the burden of maintaining an adequate railway capacity to do their business. This conclusion makes it unnecessary to discuss the question mooted whether shippers are deprived of constitutional rights when denied reasonable rates.

It should be noted that, in reaching a conclusion upon this first proposition, we are only considering the general level of rates and their direct bearing upon the net return of the entire group. The statute does not require that the net return from all the rates shall affect the reasonableness of a particular rate or a class of rates. In such an inquiry, the Commission may have regard to the service done, its intrinsic cost, or a comparison of it with other

rates, and need not consider the total net return at all. Paragraph 17 of section 15a makes this clear:

> "The provisions of this section shall not be construed as depriving shippers of their right to reparation in case of overcharges, unlawfully excessive or discriminatory rates, or rates excessive in their relation to other rates, but no shipper shall be entitled to recover upon the sole ground that any particular rate may reflect a proportion of excess income to be paid by the carrier to the Commission in the public interest under the provisions of this section."

This last clause only prevents the shipper from objecting to a particular rate otherwise reasonable, on the ground that the net return from the whole body of rates is in excess of a fair percentage of profit, a circumstance that was never relevant in such an inquiry, as hereafter shown.

Second. The carrier owning and operating a railroad, however strong financially, however economical in its facilities, or favorably situated as to traffic, is not entitled as of constitutional right to more than a fair net operating income upon the value of its properties which are being devoted to transportation. By investment in a business dedicated to the public service the owner must recognize that, as compared with investment in private business, he cannot expect either high or speculative dividends but that his obligation limits him to only fair or reasonable profit. If the company owned the only railroad engaged in transportation in a given section and was doing all the business, this would be clear. If it receives a fair return on its property, why should it make any difference that other and competing railroads in the same section are permitted to receive higher rates for a service which it costs them more to render and from which they receive no better net return? Classification of railways in the matter of adjustment of rates has been sustained in numerous cases. In the *Minnesota Rate Cases*, 230 U. S. 352, 469, 473, it was held that the rates imposed by the state upon two railways were not confiscatory, but that they were so in the case of a third railway performing service in the same territory, because the latter was put to greater expense in rendering the service. An injunction was refused to the first two railways and was granted to the third. The same principle has been upheld in analogous cases. . . .

Reliance is also had on decisions of this Court in cases where the question was of the reasonableness of state rates, and it was held

that evidence to show that the revenue of the carrier from both state and interstate commerce gave a fair profit, was not relevant. The State cannot justify unreasonably low rates for domestic transportation, considered alone, upon the ground that the carrier is earning large profits on its interstate business, and on the other hand the carrier can not justify unreasonably high rates on domestic business on the ground that only in that way is it able to meet losses on its interstate business. *The Minnesota Rate Cases*, 230 U. S. 352, 435; *Smyth* v. *Ames*, 169 U. S. 466, 541. But this conclusion does make against the use of a fair return of operating profit as a standard of reasonableness of rates when the issue is as to the general level of all the rates received by the carrier.

The reduction of the net operating return provided by the recapture clause is, as near as may be, the same thing as if rates had all been reduced proportionately before collection. It is clearly unsound to say that the net operating profit accruing from a whole rate structure is not relevant evidence in determining whether the sum of the rates is fair. The investment is made on the faith of a profit, the profit accrues from the balance left after deducting expenses from the product of the rates, and the assumption is that the operation is economical and the expenditures are reasonably necessary. If the profit is fair, the sum of the rates is so. If the profit is excessive, the sum of the rates is so. One obvious way to make the sum of the rates reasonable, so far as the carrier is concerned, is to reduce its profit to what is fair.

We have been greatly pressed with the argument that the cutting down of income actually received by the carrier for its service to a so-called fair return is a plain appropriation of its property without any compensation; that the income it receives for the use of its property is as much protected by the Fifth Amendment as the property itself. The statute declares the carrier to be only a trustee for the excess over a fair return received by it. Though in its possession, the excess never becomes its property, and it accepts custody of the product of all the rates with this understanding. It is clear, therefore, that the carrier never has such a title to the excess as to render the recapture of it by the Government a taking without due process.

It is then objected that the Government has no right to retain one-half of the excess, since, if it does not belong to the carrier, it belongs to the shippers and should be returned to them. If

it were valid, it is an objection which the carrier can not be heard to make. It would be soon enough to consider such a claim when made by the shipper. But it is not valid. The rates are reasonable from the standpoint of the shipper as we have shown, though their net product furnishes more than a fair return for the carrier. The excess caused by the discrepancy between the standard of reasonableness for the shipper, and that for the carrier due to the necessity of maintaining uniform rates to be charged the shippers, may properly be appropriated by the Government for public uses because the appropriation takes away nothing which equitably belongs either to the shipper or to the carrier. Yet it is made up of payments for service to the public in transportation, and so it is properly to be devoted to creating a fund for helping the weaker roads more effectively to discharge their public duties. Indirectly and ultimately this should benefit the shippers by bringing the weaker roads nearer in point of economy and efficiency to the stronger roads and thus making it just and possible to reduce the uniform rates.

The third question for our consideration is whether the recapture clause, by reducing the net income from intrastate rates, invades the reserved power of the States and is in conflict with the Tenth Amendment. In solving the problem of maintaining the efficiency of an interstate commerce railway system which serves both the States and the Nation, Congress is dealing with a unit in which state and interstate operations are often inextricably commingled. When the adequate maintenance of interstate commerce involves and makes necessary on this account the incidental and partial control of intrastate commerce, the power of Congress to exercise such control has been clearly established. . . . The combination of uniform rates with the recapture clauses is necessary to the better development of the country's interstate transportation system as Congress has planned it. The control of the excess profit due to the level of the whole body of rates is the heart of the plan. To divide that excess and attempt to distribute one part to interstate traffic and the other to intrastate traffic would be impracticable and defeat the plan. This renders indispensable the incidental control by Congress of that part of the excess possibly due to intrastate rates which, if present, is indistinguishable.

It is further objected that no opportunity is given under section 15a for a judicial hearing as to whether the return fixed is a fair return. The steps prescribed in the act constitute a direct and indi-

rect legislative fixing of rates. No special provision need be made in the act for the judicial consideration of its reasonableness on the issue of confiscation. Resort to the courts for such an inquiry exists under sections 208 and 211 of the Judicial Code. It is only where such opportunity is withheld that a provision for legislative fixing of rates violates the Federal Constitution. *Ohio Valley Water Co.* v. *Ben Avon Borough*, 253 U. S. 287.

The act fixes the fair return for the years here involved, 1920 and 1921, at 5½ per cent. and the Commission exercises its discretion to add one-half of 1 per cent. The case of *Bluefield Waterworks & Improvement Co.* v. *Public Service Commission*, 262 U. S. 679, is cited to show that a return of 6 per cent. on the property of a public utility is confiscatory. But 6 per cent. was not found confiscatory in *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19, 48, 50, in *Cedar Rapids Gas Light Company* v. *Cedar Rapids*, 223 U. S. 655, 670, or in *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 153, 172. Thus the question of the minimum of a fair percentage on value is shown to vary with the circumstances. Here we are relieved from considering the line between a fair return and confiscation, because under the provisions of the act and the reports made by the appellant the return which it will receive after paying one-half the excess to the Commission will be about 8 per cent. on the reported value. This can hardly be called confiscatory. Moreover, the appellant did not raise the issue of confiscation in its bill and it cannot properly be said to be before us.

It is also said in argument that the value of the carrier's property, upon which the net income was calculated, was too low and was unfair to the carrier. The value of property, it is argued, really depends on the profit to be expected from its use, and should be calculated on the income from rates prevailing when the law was passed which must be presumed to have been reasonable. The true value of the carrier's property would thus be shown to be so much higher than reported that the actual return would not be higher than 6 per cent. of it and there would be no excess.

We do not think that, with the record as it is, such an argument is open to the appellant. It did allege that the values upon which the return was estimated were not the true values, but it did not allege what the true values were. This was not good pleading and did not properly tender the issue on the question of value. Under orders of the Commission, the carrier itself reported the values of its properties for 1920 and 1921, upon which the excesses of in-

come were calculated. The bill averred that a return of these particular values was required under the orders of the Commission. This statement is not borne out by the orders themselves. They gave the carrier full opportunity to report any other values and to support them by evidence. This it did not do. We cannot consider an issue of fact that was primarily at least committed by the act to the Commission, when the carrier has not invoked the decision of that tribunal.

The decree of the District Court is affirmed.

CHAPTER VII

FREIGHT CLASSIFICATION[1]

1. Uniform Classification[2]

By the Commission:

In our annual reports to Congress we have from time to time mentioned our efforts to stimulate work in the direction of greater uniformity in freight classifications. Early in 1918 it was apparent, in view of the progress already made, that a complete unification of the rules and descriptions of articles in the official, southern, and western classifications was possible at a not distant date, and we accordingly inquired of the carriers why they could not by January 1, 1919, or sooner, effect a consolidation of the three general classifications into one volume containing one set of uniform commodity descriptions with three rating columns, one for each territory, subtended, and with one set of general rules.[3] Shortly thereafter the director of traffic of the Railroad Administration, after conference with us, appointed a special committee of experienced classification men to carry out the work we had in mind. This committee prepared and submitted a volume entitled "Proposed Consolidated Freight Classification No 1," which accomplishes the consolidation and uniformity sought, and, in addition thereto, proposes many increases and reductions in ratings, most of which, however, have no necessary connection with the work assigned to the committee. The volume was not filed with us as a tariff schedule. . . .

As we understand it, the consolidated classification was proposed as a general standard classification to supersede not only the existing issues of the official, southern, and western classifications, but also all state classifications, and at the request of the director of traffic we have received evidence as to the general effect of canceling the various state classifications. That evidence will

[1] See Jones, pp. 128–146, and Vanderblue and Burgess, pp. 98–102, and 141n.

[2] *Consolidated Classification Case*, 54 I. C. C. 1 (July 3, 1919).

[3] The term "descriptions" includes packing specifications and minimum and estimated weights. All provisions of the classification, other than ratings, will hereinafter be referred to as rules and descriptions.

be referred to later in the report. We were advised by the director of traffic that he had under consideration also the advisability of canceling the exceptions to all classifications, but that commodity rates might be established in lieu thereof in proper cases. That matter, however, has not been referred to us for investigation and recommendation.

The consolidated classification is not a uniform classification in the full sense of the term, because all the ratings are not uniform. In a majority of the items, the ratings are the same as now. The consolidated classification would preserve the identity of the official, southern, and western classifications, and, as finally amended, is intended to be filed with the Commission, with a separate I. C. C. number for each territory. In other words, from a legal or technical standpoint, it is to be three classifications in one volume. It is not much larger and is no more complicated than any one of the three general classifications now in use.

The consolidated classification is the result of effort toward uniformity extending over a long term of years, and since uniform rules and descriptions are necessary before uniformity in ratings is possible, it marks an important step toward a uniform classification. Definite action in the direction of uniformity was taken about 10 years ago, when the carriers created their committees on uniform classification, to which was assigned the duty of working out a common set of rules and descriptions for the three general classifications. This committee made disappointingly slow progress, largely because of technical considerations and the disposition of the carriers in each territory to force their views and measures of expediency upon the carriers in the other territories. It was abolished shortly after the proposed consolidated classification was prepared.

The special committee which prepared the consolidated classification consisted of the chairman of the committee on uniform classification, the chairmen of the Official and Western Classification Committees, a member of the Southern Classification Committee, now its chairman, and our classification agent. In consolidating the classifications and unifying the rules and descriptions the members of the special committee are understood to have been guided largely by their own ideas. They were not of one mind in respect to some of the changes they have proposed in the rules and descriptions. Numerous concessions were made and some long standing and deep rooted controversies growing out of

territorial or local traffic policies were cast aside. There are instances in which the existing rules as to a given situation and the descriptions, even of like articles, differ widely in the three classifications, and in respect of certain items some radical changes were necessary in order to accomplish the desired uniformity.

As stated, the consolidated classification also proposes many changes in ratings. The special committee was not directed, however, to change ratings where that was not necessarily or reasonably incident to changes in descriptions. The task assigned to the special committee was merely the completion of the work begun years ago by the committee on uniform classification, which committee had nothing whatever to do with ratings. The changes in ratings were proposed, not by the special committee as a body, but by the representatives of the respective territorial committees, individually and on their own initiative. The representative of each classification committee undertook a realignment of the ratings in his own classification, in accordance with what he conceived to be proper principles and considerations. Our representative on the special committee had no voice in fixing any of the proposed ratings. There was no concerted effort to make the ratings uniform, but the desirability of uniformity seems to have been kept in mind, and as to a number of items where there were considerable differences in the existing ratings in the three classifications, changes were proposed which effected a greater degree of uniformity, particularly in the higher classes. Changes proposed for the purpose of attaining a greater degree of uniformity have more of an upward than a downward trend.

The classification committees generally have a large number of contemplated changes in ratings in the course of investigation, either before or after they are docketed by them for consideration at their meetings with the public. Some of the changes in ratings proposed in the consolidated classification grew out of such investigations and had been decided upon by the respective committees for publication. The great majority of the changes, however, were here laid before the public for the first time. So far as the western classification is concerned most of the increases proposed are of minor importance and comparatively few of them have been protested, but in the two other territories some of the increases would apply on important kinds of traffic and have been the subjects of vigorous protests. The chairmen of the three classification committees, as representatives both of the federal controlled

and the nonfederal controlled lines, severally and jointly undertook the defense of their proposals. They have presented detailed written statements in explanation of each increased rating that was not covered by the oral testimony they offered in answer to the protests at the hearings.

Changes and new items are indicated in the consolidated classification by appropriate symbols. The special committee undertook to affix a proper symbol in every case where the classification provision might on any theory be construed as a change or new item. Based on these symbols the table below, showing the nature and number of changes and new items proposed, was prepared by the special committee and submitted with its report to the director of traffic.

Nature of Changes	Number of Changes in the Classifications			
	Official	*Southern*	*Western*	*Total*
Increase in ratings	890	2,574	393	3,857
Reduction in ratings	478	898	464	1,840
Carload ratings eliminated [1]	136	1	4	141
Increases in minimum weights	342	599	194	1,135
Reductions in minimum weights	229	73	61	363
Carload minimum weights to which rule 34 is added, subjecting them to the graduate scale	39	49	132	220
Additions or new items	1,144	1,665	425	3,234
Total	3,258	5,859	1,673	10,790

As will be seen, the increases in ratings in the official classification greatly outnumber the reductions, there being 890 increases and 478 reductions. With respect to the western classification the situation is reversed, the reductions in ratings outnumbering the increases, there being 464 reductions and 393 increases. The greater number of increases in ratings in the official classification than in the western classification may be attributable in some measure to the fact that the official classification had not received as much upward revision in recent years as the western classification, probably because the official classification committee has only recommendatory powers, and was not free to make changes which it was convinced should be made. In the southern classification the increases in ratings far outnumber

[1] The number of carload ratings established does not appear, but they are included in the reductions.

the reductions, there being 2,574 increases and 898 reductions. This is due to the fact that at present many articles that are in the higher classes in the official and western classification are rated lower in the southern classification, and it is proposed to bring a large number of ratings in the southern classification up to or nearer to the bases observed in the two other classifications. In the southern classification proposed increases of two classes are quite common, and there are some instances in which the increases are even greater.

An increase of one class in rating effects an increase in freight charges ranging generally from 15 to 25 per cent. Many of the protestants referred to the several recent general increases in freight rates and suggested that this was not a desirable time to require shippers to bear further increases, even though they might be reasonable when considered strictly from a technical classification standpoint. Many reductions are proposed, but it happens that upon the whole they do not apply to traffic of the same importance as do the increases, and so far as the individual shipper is concerned the reduction can not, as a rule, be said to neutralize or offset the increases, for the reason that the shipper who would suffer an increase probably would not, in most instances, be the one who would benefit by a reduction.

Owing to the fact that more increases than reductions are proposed and to the fact that the increases would apply on more important lines of traffic, or at least on a greater tonnage, than would the reductions, the consolidated classification would bring the carriers some additional revenue. . . .

We have stated that the consolidated classification marks an important step toward a uniform classification. Our hitherto most important case in which the matter of classification uniformity was considered was the *Western Classification Case*, 25 I. C. C., 442, decided December 9, 1912. In that proceeding the lines parties to the western classification sought to establish a large number of changes, including revised rules and descriptions which had been recommended by the committee on uniform classification. We there discussed classification matters rather fully and stated that in our opinion a uniform classification was practicable, but that there were great difficulties to be overcome, particularly in so far as uniform ratings are concerned. In the instant case several traffic organizations, one or two state commissions, and a number of the shippers who would be adversely

affected by the changes proposed in the consolidated classification as a result of efforts toward uniformity went on record as being opposed to, or at least not advocating, a uniform classification, contending that there are such wide differences in conditions in the various parts of the country as to make a uniform classification impracticable and undesirable. We are now, as formerly, fully convinced that a uniform classification, with such exceptions or commodity rates as may be necessary in special cases, is practicable and desirable, and practical uniformity should not be unnecessarily delayed. Naturally there must be both increases and reductions, which may adversely or advantageously affect individual shippers and carriers, but a broad view of the situation justifies the statement that carriers and shippers alike will be amply repaid in the end by the benefits which will accrue from uniformity. The fact that a uniform classification would be of convenience is a consideration of relatively minor importance; we have advocated uniformity because it is an essential part of the general scheme which contemplates greater consistency in rate making and elimination of discriminations and inequalities.

Placing the ratings in juxtaposition in three parallel columns opposite the descriptions impresses us as never before with the great lack of consistency that exists among the three classification territories. Many of the inconsistencies are due to considerations of minor importance and could be removed without changes in rate scales and, in our view, without serious effect upon any one, particularly in so far as less-than-carload ratings are concerned. In large part different ratings in the three territories are not due to actual or substantial differences in circumstances and conditions, but are the result of mere differences of opinion and the natural inclination of traffic officials to give expression to their respective theories of classification. For instance, on furniture in less than carloads, the chairman of the official committee, following a practice of long standing in his territory, proposes the same rating for the articles wrapped as for the articles boxed or crated. The chairmen of the southern and western committees in some instances do the same thing; in others they do not, but propose ratings one or two classes higher for articles wrapped than if boxed or crated. Moreover, the proposals of the three chairmen, even as to one and the same article of furniture, are in some cases directly opposed to each other. An interesting

example of this is shown below. The ratings are for less than carloads.

Page	Item	Article	Ratings: Official	Ratings: Southern	Ratings: Western
		Furniture:			
180	8–9	Benches, dentists laboratory—			
		Wrapped in burlap	1½	1½	1½
		In boxes or crates	1½	1	1½
181	11–12	Kitchen cabinets, set up—			
		Wrapped in burlap	D1	1½	1¼
		Wrapped in fibreboard	D1	1½	1¼
		In boxes or crates	D1	1½	1
184	1–2	Chifforobes (chiffoniers and wardrobes combined), set up—			
		Wrapped in burlap	1½	1½	D1
		In boxes or crates	1½	[1] 1½	1½
185	13	Wooden desks, set up—			
		Wrapped in burlap or fibreboard	1½	1½	1¼
		In boxes or crates	1½	1	1
		Wooden desks, knocked down—			
		Wrapped in burlap or fibreboard	1¼	1¼	1
		In boxes or crates	1¼	1	2

Several other examples of lack of uniformity, most of which could probably be dealt with without great difficulty, are shown below. The ratings are for less than carloads.

Page	Item	Article	Ratings: Official	Ratings: Southern	Ratings: Western
150	2	Electric exhaust fans	2	1	D1
322	10	Dressed poultry:			
		In barrels with cloth tops	1½	1	1
		In barrels or boxes	1¼	2	1
388	27	Canned vegetables, etc.:			
		In glass or earthenware, packed—			
		In crates	1	2	3
		In barrels or boxes	2	2	4
		In metal cans—			
		In crates	3	2	3
		In barrels or boxes	3	3	4

We show below a few examples of lack of uniformity that probably had their origin in peculiar conditions of the distant past.

[1] Conceded first class at hearing.

Page	Item	Article	Ratings		
			Official	Southern	Western
115	9[1]	Banana carriers, old, any quantity....	4 t 1	D1	4
165	24	Rice flour:			
		Less than carloads................	4	6	3
		Carloads........	6	C	5
166	12	Fodder, in machine-pressed bales:			
		Less than carloads.................	1	5	3
		Carloads...	5	D	C

The instances cited in these tables are typical of thousands of others that probably would not exist but for the fact that the respective classification committees have for years followed precedents and have acted according to their different opinions or upon different information. Recently they have been working more in unison, and when additional provisions are established to cover new articles of commerce the ratings are generally made uniform, except when to do so would violate some unusually important and well-established policy in one or more of the territories.

The continued use of the intermediate or split classes of R–25 and R–26 in the official classification constitutes one of the principal difficulties in reaching uniform ratings on the higher classes of freight. R–25 is 15 per cent less than second class, subject to third class as a minimum. R–26 is 20 per cent less than third class, subject to fourth class as a minimum. These classes were formerly used to a rather limited extent, but additional articles have been assigned to them from time to time, until in the consolidated classification they are numbered by hundreds.[2]

While it is possible to remove many of the present inconsistencies without changes in rate scales, it should also be borne in mind that an absolutely uniform classification could be prepared

[1] In supplement.

[2] R–25 rating is proposed on 387 articles in less than carloads. The ratings proposed on these articles in southern territory are second class or higher in about 44 per cent of the cases and third class or lower in the balance of the cases.

The ratings proposed on the same articles in western territory are second class or higher in about 54 per cent of the cases and third class or lower in the balance of the cases.

R–26 rating is proposed on 401 items in less than carloads. The ratings proposed on these items in southern territory are third class or higher in about 43 per cent of the cases and fourth class or lower in the balance of the cases.

The ratings proposed on the same items in western territory are third class or higher in about 66 per cent of the cases and fourth class in the balance of the cases.

We have no figures as to the articles that are rated R-25 and R-26 in carloads.

and proposed only in connection with a universal system of rate scales having a uniform number of classes. In our view a desirable arrangement would be to have in each scale at least ten classes related somewhat as shown below; practically all less-than-carload traffic to be confined to the first four classes, and a redistribution made of the articles in the carload classes:

Classes	1	2	3	4	5	6	7	8	9	10
Percentages	100	85	70	60	45	35	30	25	22½	20

Many articles that now move under commodity rates and under exceptions to the classifications could be assigned ratings in such a scale that would result in the application of rates not substantially higher or lower than now apply. This would be particularly true of the official and southern territories. The percentages in the above scale do not differ greatly from those observed in a large portion of the country. . . .

As we have pointed out, most of the increases proposed have no necessary connection with the work of consolidating the rules and descriptions. None of them, except such as were necessarily or reasonably incident thereto, were contemplated by us when we suggested a unification of the rules and descriptions, and, as we understand it, were not in the mind of the director of traffic when he appointed the special committee. When the case was assigned for hearing we did not realize that there was such a vast number of changes that had no necessary connection with the work required of the special committee, and, as we understand it, the executive authorities of the Railroad Administration themselves were not fully cognizant of the magnitude of the proposal which had been put forward. . . .

GENERAL CONCLUSIONS

So far as rules, descriptions, packing specifications, and minimum and estimated weights are concerned, and subject to the modifications thereof indicated in this report, we recommend the adoption of the consolidated classification for application in lieu of the present official, southern, and western classifications by carriers under federal control. We do not recommend any changed ratings except as the establishment of new items may indirectly effect changes, and such as may be a reasonably necessary part of the establishment of uniform descriptions, specifications, or minimum weights.

The same rules, descriptions, packing specifications, and minimum and estimated weights subject to the same modifications and limitations are, tentatively, and without prejudice, found just and reasonable for carriers not under federal control. . . .

2. Classification Principles

a. high value: silk [1]

Meyer, *Commissioner:*

Raw silk may consist of the silk thread as imported; the thrown silk, which is several threads combined by what is known as the process of throwing; or spun silk, sufficiently described by its name. There is a small amount of artificial raw silk, which is not differentiated from other raw silk. Silk waste consists of fiber from the cocoon from which silk is taken which can not be reeled, fiber left in the process of manufacturing spun silk and which is called noils, or cocoon remnants and punctured or pierced cocoons. Complainant, a corporation organized not for profit but for the protection of the interests of its 300 members, asks in this proceeding that, regardless of value, the rating in the official classification of raw silk on wooden spools, bobbins, or warp beams, and waste silk in bags, bales, or boxes, less than carload, be made second class; and of other raw silk first class. The present ratings assailed as unjust and unreasonable and unjustly discriminatory and prejudicial are first class on silk waste and on raw silk of a value not in excess of $1 per pound and one and a half times first class on raw silk in excess of that value. As all raw silk, except a negligible quantity called Tussah silk, is worth more than $1 per pound, the practical effect of the present classification is a rating of one and a half times first class on raw silk throughout official classification territory. Prior to 1903 raw silk was not rated in official classification but was accepted for transportation by special agreements only. In that year raw silk and waste silk were accorded a rating of first class when released to a value of $1 per pound; and three times first class when not so released. Upon the passage of the first Cummins amendment the present tariff rating on raw silk was filed to become effective June 2, 1915. The rating on silk waste has not been changed since 1903.

Under the tariffs prior to June 2, 1915, shippers of raw silk

[1] *Silk Association of America* v. *Pennsylvania Railroad Company,* 44 I. C. C. 578 (May 5, 1917). See also 50 I. C. C. 50; and Jones, pp. 88, 133, and Vanderblue and Burgess, pp. 98–102, 141.

could pay the first-class rate at the released value and obtain insurance for the full value at a cost not in excess of 10 per cent of that rate. The present rating results in an increased rate, the burden of proof to justify which is on the carriers. No increase has been made in the ratings on silk waste since January 1, 1910.

The average value of raw silk is $3.84 per pound. The value per shipping pound of the different kinds of raw silk and silk waste is as follows:

Commodity	*Raw silk*	*Thrown silk*	*Spun silk*	Waste		*Noils*	*Thrown silk on spools*	*Spun silk on spools*
				Asiatic	*European*			
Density or weight per cubic foot, pounds........	22	15	28	30	9	8	20	20
Value per gross shipping pound	$3.20	$3.75	$2.30	$.65	$.60	$.28	$2.00	$1.25

The "shipping pound" includes the weight of the package in which the silk is shipped; and, when used, the spool, bobbin, warp beam, or cone on which it is wound.

Raw silk is transported from importer to throwster, thence to the dyer, and back to the importer, so that the carriers obtain three, sometimes more, hauls of the same commodity. However, much of this transportation is by express on which shipments the carriers receive from the express companies more than when shipments are made by freight. Shipments are made in well packed bales weighing from 108 to 240 pounds, the average shipment of the raw article being from 10 to 15 bales, and of thrown silk 1 to 2 bales.

The concentration of value in shipments of raw silk and silk waste makes such shipments hazardous to the carrier. This is illustrated by an exhibit of record showing one shipment of 20 bales of a value of $11,136, 22 shipments consisting of 139 bales valued at $77,510.40, and 24 shipments of 147 bales valued at $84,940.80. One wreck cost a carrier in payments for loss of these commodities $10,680.70, as much as its revenues from the traffic thereon for two years. The loss and damage claims paid, taking all the shipments on which the record shows such payments, are, however, not in excess of 1 per cent of the revenue paid thereon and are less than the percentage of loss and damage payments to revenue

received from all commodities. Insurance against all loss could be obtained at a cost amounting to from 5 to 10 per cent of the first-class rate, but the insurer reserves the right of subrogation against the carrier in case of loss.

The increase of 50 per cent in the rating on raw silk can not be justified and is not sought to be justified solely because of the increased hazard resulting from the full liability required by the first Cummins amendment. The increase in the hazard is not the only fact to be considered in prescribing rates for the transportation of highly valued commodities. The Supreme Court in *N. P. Ry.* v. *North Dakota,* 236 U. S., 585, 599, in giving some of the many factors which should be considered in making rates, names "the risk assumed" and also "the value of the service." This Commission has throughout its history given consideration to the value of a commodity when determining what is a reasonable rate thereon.

Illustrative of the value of service is the percentage that the rate paid bears to the value of the article. This percentage on raw silk is less than 0.15 of 1 per cent, while such percentages on other articles of necessity and daily use are much higher. Below is a table introduced in evidence by the chairman of the official classification showing such percentages:

	Per cent		*Per cent*
Butter	0.9	Beans	4.8
Clover seed	1.2	Potatoes	14.8
Cotton	1.6	Sweet potatoes	5.0
Eggs	1.3	Oats	6.0
Apples	13.6	Barley and rye	7.3
Corn	9.2	Hay	15.8
Average for all grains	7.7	Cattle and hogs	2 5
Live poultry	4.5	Wood	0.6

Silk is one of the commodities of the highest value in proportion to the ratio which the charges bear to the value of the commodity.

Because of the "less value per shipping pound" of the commodity when shipped on spools, bobbins, etc., complainant contends that there should be lower rates on such shipments. This contention is based on the one element of ratio of value to density and disregards the value of the service. Such an extreme differentiation is not practicable, especially on a commodity like spun or thrown silk when shipped in less-than-carload quantities. Some such silk is wound on cones or paper coils, as to which no relief is asked. To make the rates on silk wound on spools and bobbins different from the rates on silk wound on cones and paper coils

would lead to an impracticable multiplication of rates. While in the general description of dry goods, classified first class in less-than-carload shipments, there are included some commodities like velvet of a value somewhat similar to that of silk, no unjust discrimination or undue preference results. The dry goods list must be considered as a whole and this record presents no justification for including raw silk in that clsssification.

From all the facts of record we find and conclude that the rates assailed are neither unreasonable nor unjustly discriminatory, and the complaint will be dismissed.

B. FRAGILE AND BULKY COMMODITY [1]

CLEMENTS, *Commissioner:*

The complainant is a corporation engaged in the manufacture and sale of office furniture and supplies, with plant and principal office at Norwood, Ohio, a point on the Baltimore & Ohio Southwestern Railroad 10 miles from Cincinnati, Ohio. Among other articles it ships sectional bookcases, each section being packed in a box of double-faced corrugated strawboard of single thickness. By complaint it challenges the reasonableness of the rating in the official classification of one and one-half times first class on these bookcases, so packed, alleging that the resulting charges are unreasonable and subject complainant to undue prejudice and disadvantage. It asks for the establishment of a rating of first class.

Except those for export, which are packed in large wooden boxes lined with waterproof paper, all of the sectional bookcases shipped by the complainant are packed in the manner described, and their average weight is slightly more than 7 pounds per cubic foot. Complainant prepays the freight in practically every case and sells at uniform prices at all points east of Montana, Wyoming, Colorado, and New Mexico. The testimony does not indicate that the method of packing described has been adopted generally, it appearing, in fact, that sectional bookcases are shipped both knocked down flat and in tiers, crated or boxed.

The classification ratings hereinafter referred to are those applicable on less than carloads. In the official classification bookcases, including those of the sectional variety, and bookcases and desks combined, wrapped, crated, or boxed, are rated one and

[1] *Globe-Wernicke Company* v. *Baltimore and Ohio Railroad Company,* 31 I. C. C. 274 (July 10, 1914).

one-half times first class. In the southern and western classifications sectional bookcases, when boxed, are given a rating of first class, but take the regular bookcase rating of one and one-half times first class when shipped otherwise than in boxes. In all three classifications sectional bookcases, knocked down flat, are rated second class. First-class ratings have been established on sectional bookcases, boxed, in the Illinois, Texas, and Canadian classifications.

In *Globe-Wernicke Co.* v. *B. & O. S. W. R. R.*, 11 I. C. C., 156, 164, the Commission considered the reasonableness of the rating here complained of, and its conclusions were as follows:

> The foregoing facts indicate that complainant's request for first-class rating of sectional bookcases should be fairly considered by the carriers in official classification territory. This kind of bookcase has been voluntarily placed in the first class by both the Southern and Western Classification Committees, and there is much reason to believe that it might properly receive the same treatment by the Official Classification Committee. It does not follow, however, that one and one-half times first-class rates for all bookcases is an unlawful discrimination against the sectional variety, which is one of the questions presented by this record, and we are not satisfied that there is such difference between the bookcase of complaint and other bookcases as to require a lower rating for the former than for the latter. To establish discrimination in rates resulting from the classification of articles of the same general character there must be preponderating proof in favor of a complaining party, and we are constrained to hold that the evidence in this case is not of that decisive character. Upon the proofs presented we are of the opinion that the sectional bookcase is not entitled to a different and lower rating than is applied to other bookcases and that the action of the carriers in fixing the same classification and rates for sectional as for other bookcases does not exceed the limits of their discretion.

We further held that the charges on sectional bookcases were not shown to be unreasonable, but did not find that they were reasonable and dismissed the complaint without prejudice.

At the time of that decision, in 1905, the complainant shipped sectional bookcases in crates, several sections to the crate. The difference in packing, which, however, did not result in greater density, as in crates the average weight was found to be 7 pounds per cubic foot, is the only substantial change since that date in the conditions of transportation, other, of course, than the increase in the tonnage of sectional bookcases.

In the former case it was found that the commodity named furnished a larger volume of traffic than any other article rated the same in the official classification and that complainant's shipments constituted a little more than one-third of such traffic. It here appears that the number of manufacturers has increased from 12 to 60 and complainant's output about one-third, aggregating over 400,000 sections for the year ended May 31, 1913. It was also found in the former case that sectional bookcases were probably more remunerative to defendants than any other traffic taking the same rates, but that if put into first class they would be less desirable traffic, from the carrier's standpoint, than any one of the large majority of articles accorded the latter rate, though they would pay the carriers rather better than a number of articles carried at first class.

The complainant now contends that sectional bookcases, packed in strawboard boxes, are a very desirable traffic, which can be loaded with little trouble on top of or around other freight in mixed carloads, and that the only damage resulting is an occasional breakage of glass, the cost of replacing which generally is too small to warrant the filing of claims. The defendants, on the other hand, contend that these shipments so boxed have to be "top-loaded" and that, due to the fact that strawboard is easily punctured, care has to be taken as to the nature of surrounding articles; further, that either in handling or packing a large crate containing several sections is preferable to several small packages each containing one section and that crates furnish as satisfactory protection as strawboard boxes. The claims for damage in transit are small in either case. The defendants also point to the fact, heretofore stated, that the change in the method of packing has not resulted in greater density, the average weight per cubic foot being substantially the same.

The complainant also contends that the existence of the first-class rating in the other principal classifications raises a presumption that it would also be reasonable in the official classification territory and that the rating should be made uniform throughout the country. In answer the defendants state that the carriers in the south and west, desiring to encourage immigration to their territories, have been very liberal in their ratings on furniture and emigrants' movables, and that the less-than-carload furniture ratings average lower than those in the official classification, but that in view of the fact that the class rates are lower in official

classification territory than in the other territories it does not follow because the rating is higher that the rates are higher or are unreasonable.

Upon consideration of the facts of record we see no reason to change our views expressed in the former case as to the rating of sectional bookcases. It is disputed, and the testimony is not convincing, that the change in the method of packing this commodity has resulted in substantial economy of transportation and, upon the record before us, we can see no justification for ordering the establishment of a rating on sectional bookcases, boxed, lower than on that commodity shipped in crates, or lower than on bookcases of other varieties. We are further of opinion that the rating of one and one-half times first class has not been shown to result in rates which are unreasonable or unduly prejudicial to complainant. The complaint will therefore be dismissed, and it will be so ordered.

CHAPTER VIII

COMPETITIVE RATE MAKING [1]

1. How Tariffs Grew

The chaotic condition of present railway tariffs [1891] is the result of years of growth. They have been evolved by a multitude of circumstances and conditions. The first schedule of rates upon a new road in a non-competitive territory is based upon sound principles. There are two principal divisions of the expenses of railway transportation. (1) The cost of terminal or station work. (2) The cost of handling.

As every shipment requires station work, at both the forwarding and the receiving station, and as these station expenses are the same whether the haul is ten miles or five hundred miles, it follows that the rate per mile must be materially greater for a short haul than for a long haul. For example: suppose it is assumed that three cents per hundredweight, or sixty cents per ton, is the proper charge to cover the station expenses at each end of any given shipment, and one half cent per ton per mile is the right amount to charge for hauling, the mathematical calculation to ascertain the proper rate per ton per mile for ten and for five hundred miles would be as follows: To the two station expenses, sixty cents each, and for the ten miles haul one half cent per mile; and the total, $1.25, the proper charge for ten miles, would be equal to an average of twelve and one half cents per mile. The same calculation would give $3.70 as the rate per ton for five hundred miles, or an average per mile of only seventy-four one hundredths of a cent. Now, if a manager or his freight agent were called upon to make a tariff for a new road in a non-competitive district, whether he copied an old tariff which had been in effect at some former time on a road similarly situated, as he probably would without thinking of the underlying principles, or was compelled to rely upon his own resources, the schedule which he would produce would be substantially on the basis of this mathematical calculation. There is equally substantial basis, agreeing with sound reason, for dis-

[1] From A. B. Stickney, *The Railway Problem*, chapters VI and VII (1891). See Jones, pp. 105–114, and Vanderblue and Burgess, pp. 59–62.

tinctions in rates between different classes and commodities, which it is not necessary for present purposes to specify. A tariff thus constructed and impartially adhered to would be equitable as between all customers, and would admit of the freest competition in trade between individuals and localities. The long haul rate would always be the sum of the two local rates less two station expenses, which would be as it should be; that is to say, if a shipment were made from New York to Chicago, and then reshipped to St. Paul, there would be the expense at both the receiving and the forwarding stations at Chicago, which would not be incurred if the shipment were made directly from New York to St. Paul. The companies are entitled to this additional expense, and no more. As here used, the word "expense" includes a reasonable profit for the services performed.

Starting with this primal form of tariff, it is proposed to trace it through its various stages of evolution to the chaos of the present; noting from time to time the most important changes and the causes of them, from the manager's point of view. To comprehend these changes, different tariffs must be examined in detail and compared with one another. But as schedules of rates are of necessity a mass of figures, readers could hardly be expected to spend the time and labor necessary to make examinations and comparisons from pages of columns of figures. Hence there has been prepared a series of diagrams which will show the facts at a glance.

DIAGRAM No. 1 [Plate 5] represents the primal, impartial, mathematical schedule, built upon the basis which has been stated.

This schedule is uniformly systematic. A class which bears a higher rate than another at one station maintains that relation at every station; for if there is reason for charging more for transporting dry goods than for transporting coal for the distance of ten miles, the same reason applies for similar differences for every other distance. Why should the principles of this tariff ever be changed? In answering this question, space will permit the mention of only a few of the almost countless arguments which are continually being presented to managers as reasons why changes, or at least exceptions, should be made.

(1.) The first is in relation to the wheat traffic, to which reference has already been made. About half the line is newly built, and for the reasons stated in a previous chapter, the manager thinks it for the interest of both the road and the people to induce some man

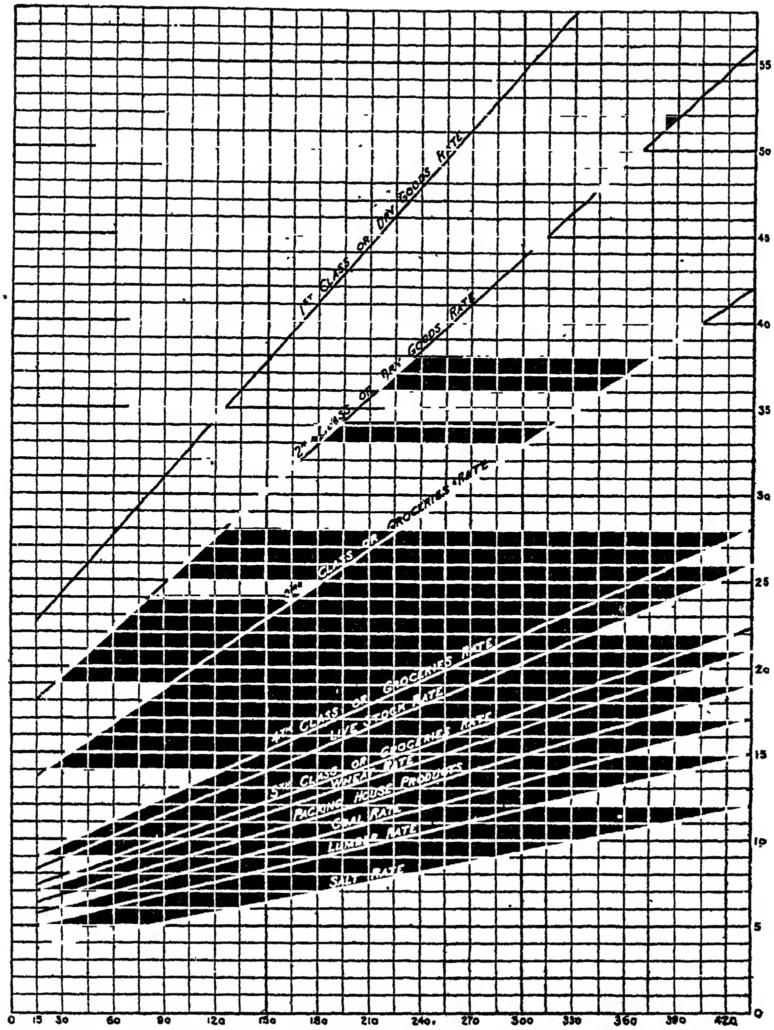


PLATE 5. DIAGRAM No. 1.—Represents the Primal Mathematical Tariff

The figures at the bottom represent miles, the figures at the side, cents per cwt., the diagonal lines the rates. To illustrate its use: To find the rate on third-class goods for 180 miles let the eye follow up the 180 mile line, which is perpendicular, till it reaches the third-class rate line; then see on the side margin the number of cents; the horizontal line at that point indicates which is the rate—(25 cents).

with sufficient capital to engage in building elevators and buying wheat. As an inducement, he agrees to lower the rate on wheat to his man from a certain point, say two hundred miles out, to the end of the line; but while doing this he sees no reason why he should lower the rate proportionately on the first two hundred miles, where the business is already established. Who can say that, from the manager's point of view, there does not seem to be reason in this? So the wheat line in the diagram is broken at the two hundred mile point, or bent downward.

(2.) At about the same two hundred mile point the State has established its capital, and quite a young city has sprung up. A bright, active young man walks into the manager's office, and represents that he has capital and experience, and desires, if the railway company will make concessions in the matter of rates, to start a wholesale grocery house at the state capital. He promises great things,—a jobbing centre, manufacturing population, etc. The manager listens, is convinced, and reaches up to the grocery line on the diagram and pulls it down at the two hundred mile point to encourage the jobbing in groceries, leaving it where it was at all other points. The dry goods jobber asks the same concession, and having made it for one, the manager makes it for the other.

(3.) The coal miner comes in. He says: "Mr. Manager, the people on the west end of your line burn but little coal; wood is too cheap to admit of it unless you can reduce your rate. The rate for one hundred and fifty miles is $2 per ton. The coal costs $1 at the mines; plus the freight, it costs $3 one hundred and fifty miles away. At this price I can sell some coal in competition with wood; if you could continue that rate to the end of your line, I could increase my trade to include all your territory, while with your present rate I can do but little." The manager is in doubt, but the road is new, business is light, stockholders are clamoring for more earnings, and, in the hope that it will amount to something, he consents, and flattens the coal rate from the one hundred and fifty mile point.

(4.) Then comes the lumberman. He says: "Mr. Manager, I don't know anything about railroading, and I think your lumber rate is low enough; but if you could make a little concession at the state capital and at the extreme end of your line, I think I could sell a good many more cars of lumber at these two points. You know the capital is growing, and a good many settlers are going

out beyond the end of the track, and that town at the end is growing. I think it would be a good thing for both of us." The manager still has some doubts, but, for the same reasons that governed him before, he comes to the same conclusion as he did in the case of the miner. He now makes a downward kink in the lumber line at the two hundred mile point, and another at the extreme end.

These are but specimens of the almost countless applications for special rates for special reasons which seem to have force in them.

Diagram No. 2 [Plate 6] represents the condition of the manager's schedule after he has made special arrangements with the wheat buyer, the grocery and dry goods merchants, the coal miner, and the lumberman. It would be difficult to show, on so small a scale, its appearance after the "butcher, the baker," and "the candlestick maker" have been dealt with. It has lost its symmetry, weakened the hold on the principles of its construction, and is adrift on the sea of discrimination, dealing with a prodigious number of isolated transactions without any fixed rule.

The transition from a government of law, founded upon reason and fixed principle, to a government by chance or by the will of the manager is complete; and this has been brought about without the complications arising from competitive railways. Understanding the facts, no one would be inclined to impute any but the purest motive to the managers, the desire best to conserve the interests of their companies. But it must be evident that, having deserted the fixed rule for determining rates, the most important function of railway management, the manager is thereafter compelled to deal separately with an enormous number of disorganized and separate rates, having no cohesive ties, but each based upon orders direct from headquarters. As a matter of fact, although the companies from time to time issued printed schedules of rates, up to the going into effect of the Interstate Commerce Law in 1887, no considerable shipper regarded them, but secured a special rate on each shipment.

It will be seen at once how discrimination tends to build up important towns at certain points, such as the supposed state capital and the end of the line, in the illustrations. Lowering the rates at these points had a tendency to draw population and business to these localities as naturally as water flows downhill. The "long haul" theory has always been potential in causing managers to favor the localities at the western end of their lines. It is evident

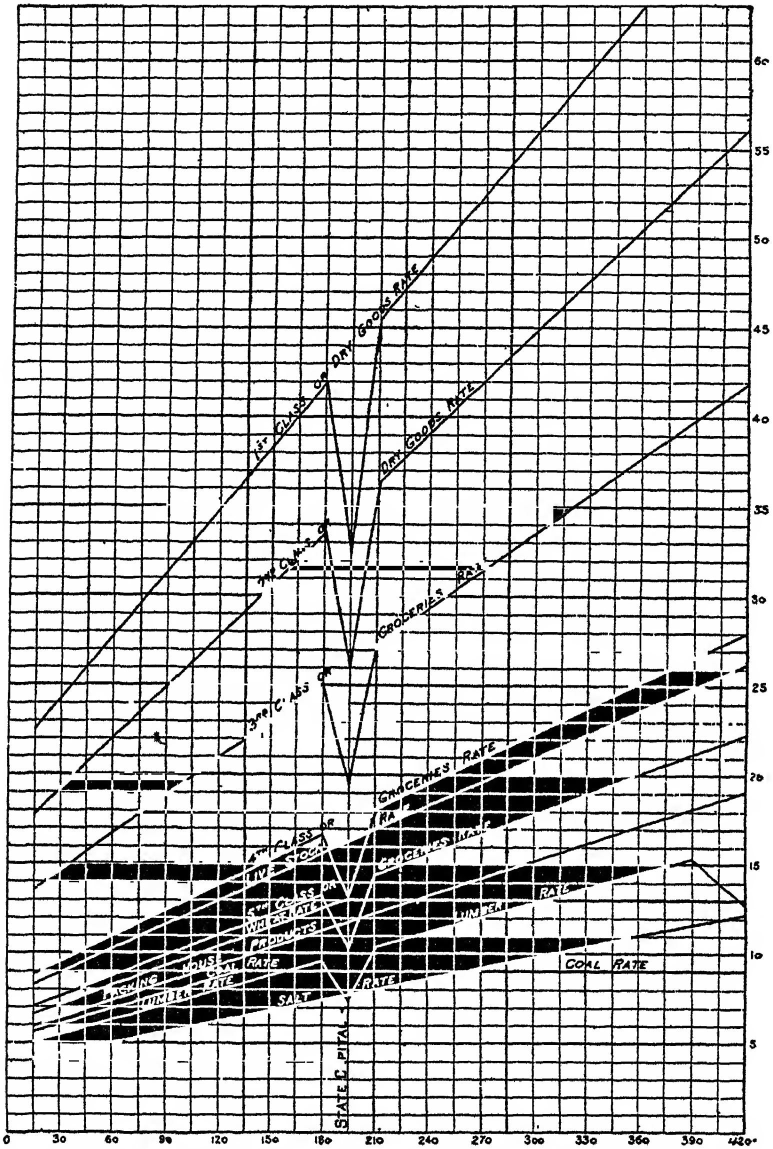


PLATE 6, DIAGRAM No. 2.—Represents the Primal Mathematical Distorted by a Few Special Rates.

that, as long as the tariff is constructed on the mathematical principle which gives a uniform profit upon each mile of haul, a ton of freight which is hauled four hundred miles will give double the profit that will accrue from a ton of freight hauled two hundred miles. Hence, under these circumstances, a manager who was interested in making profits for his company would naturally look with more favor upon building up a large city at the end of his line, where, generally speaking, he would get a four hundred mile haul, than at the middle of his line, where he would get only a two hundred mile haul. Therefore it is easy to see how the long haul *at proportionately long rates* might become popular from the manager's point of view. This was undoubtedly the original long haul theory, the words "long haul" being supplemented with the important addendum, "at proportionately long rates." The propensity of Americans to abbreviate language robbed the phrase of its addendum, so that "long haul," pure and simple, became the catch-word of the traffic departments, and, from the common habit of substituting words for ideas, the "long haul," regardless of rates, became a controlling maxim. Thus, for many years before the advent of the Interstate Commerce Law, the rate between Chicago and the Missouri River towns and St. Paul and Minneapolis (four hundred to five hundred miles), then the termini of the Western roads, was but little more than the rate from Chicago to the Mississippi River towns of Burlington, Rock Island, Clinton, and Dubuque (two hundred miles), the intermediate country being charged much higher rates except at competitive points. This has worked a great injustice to the latter cities. Thirty years ago they were nearly as important in respect to trade and population as they are at present, and relatively to the surrounding country more important; while St. Paul, Minneapolis, Omaha, and Kansas City, then mere trading posts, have now, largely by reason of such discrimination, become important cities of national repute.

It seems impossible that any set of men could become so befogged by a form of words as to suppose that it was profitable for a railway to haul a ton of freight five hundred miles at substantially the same price as for hauling it two hundred miles, yet a reference to the tariffs of these railways would tend to show that such is the fact.

This long haul policy has done, and is now doing, great mischief to the corporations as well as to the people. The towns which

have profited by it during the last thirty years have become, instead of terminal stations, but midway stations on transcontinental lines; and if the long haul craze continues, they will probably suffer for the next thirty years in the same way that the Mississippi River towns have for the past thirty years.

The management of railways may find some excuse for the error of breaking loose from the rule (the writer believes that it was an error) in the fact of the newness of the business. All the other great departments of business have a history; they have had their childhood, their youth, and their maturity. Their history has created certain traditions or unwritten codes of law which experience has proved must not be disregarded. Thus, mercantile pursuits, insurance, banking, etc., have traditions founded upon sound principles, and yet thousands of men who have never thought about, and perhaps would be incapable of comprehending, the underlying principles, simply by following the traditions of the craft are successful merchants, bankers, etc. So the principles of trade and finance in a more comprehensive sense have been studied by some of the ablest minds, and the result of some centuries of thought, through a process of imperceptible dissemination and absorption, has pervaded the minds of successive generations with certain broad principles of recognized importance which have become a common heritage. But the business of railway transportation has no history, no traditions, no peculiar heritage. Little thought has been given to its theory or to its underlying principles. Now just past fifty years of age, its life has been one of action instead of philosophical inquiry into the underlying laws which control its peculiar operations. . . .

2. Competitive Tariffs

The development of tariffs upon competitive lines is based upon principles different from those upon non-competitive lines. In order to understand this, the relations existing between the managers of the different companies must be considered. In their personal affairs and in their relations to their own companies, their conduct has been, as a rule, above reproach. But it is probably not putting it too strongly to say that, as managers, they have always been intensely jealous of each other's power, and no manager has ever been known to scruple at any means to cripple a rival in his autocratic position. Among themselves their word has been worthless. Their agreements as to territorial boundaries

and as to methods of conducting traffic have no sooner been made than broken. As long as the country contiguous to any line was poor and possessed no important towns or developed industries, there was nothing to excite the greed of a rival, and the territory was unmolested. But as soon as an important industrial centre sprang up, the rival company would build a branch line to it, and then the chieftains would at once put on their war paint and make ready for the fray. To the writer's mind, there is a striking similarity between the railway managers of twenty years ago and the Scottish chiefs of say four hundred years ago. One historian described the latter as follows: "The ferocious Highland chiefs were always at hand. Anything which bore even the resemblance of wealth was an irresistible excitement to their cupidity. They could not know that a man had property without longing to steal it, and, next to stealing, their greatest pleasure was to destroy." . . .

During the era of raids and reprisals a great many competitive points were established. The history of one is the history of all. Before there was competition, the manager would claim that his rates were as low as was consistent with justice to his company. But as soon as another road was built, or even before it was completed, he would reduce his rates, sometimes fully one half. Then the new road would reduce them still lower. After this, a system of buying business by private bargain with individual shippers would follow. So, by rapid strides, the rates would be reduced to nearly nothing, at which point they would remain for months together. Then would follow a truce and a partial restoration of rates; then a relapse, to be succeeded by another truce. But until the enactment of the Interstate Commerce Law these low rates at competitive points did not affect those of intermediate localities.

The making of rates at competitive points became a question not so much of what was fair and reasonable as of what could be obtained against the watchfulness of the other company. Low rates were made, not to encourage new trade, as was the case with non-competitive roads, but in order to secure the largest share of the business, and, failing in that, to prevent the other company making a profit. The principle of these methods seems to have been the essence of the Highland instinct of four hundred years ago. In the early years each company was ambitious to claim the merit of having caused the last reduction; but of late, since

the matter has gone beyond control, and disaster seems imminent, each charges the responsibility of the first cut upon the other, and claims that it has accepted the rates only from compulsion. If we turn to Diagram No. 1, and imagine each line of rates pulled down to any haphazard level at each competitive point, without being changed at intermediate stations, it would represent a tariff as thus far developed. It would represent the tariffs about as they existed when the Granger agitation first commenced, with very low rates at all competitive points, thus discriminating between localities; and with different rates to different individuals, thus discriminating between persons.

It is believed that the causes which first developed these characteristics in competitive tariffs have been fairly stated.

At the outset they were undoubtedly induced more by ill temper and a disposition to measure strength than by any settled convictions of true business policy. Later on, it is true, after the attack was made, the companies attempted to justify them on business principles. But it must be conceded that these specious arguments were an afterthought.

These tariffs once established, year by year the rate at competitive points gradually sank lower and lower. These reacted to a certain extent upon non-competitive rates; for, as the difference increased, the logic of figures began to assert its influence. By sophistry men might appear to justify a difference; but when the rate for hauling a ton of freight four hundred miles was only say one third of the rate for hauling a ton two hundred miles over the same road, it seemed too absurd, and it was usually remedied by lowering the higher rate.

If it be found impossible, in the light of the present day, to justify these methods, either on business principles or on the selfish plea of advantage to the companies, it must be admitted that they were strictly in accordance with precedents which had been established by older companies in older communities, and therefore it ought to be conceded that the managers, in establishing them, might have been unconscious of acting against the best interests of their companies.

Indeed, it was not immediately apparent that they were prejudicial to the companies. At that time the amount of business at competitive points, compared with the business at non-competitive points, was relatively much less than it is now; therefore, since the non-competitive rates were held up, the cutting of com-

petitive rates only slightly affected the aggregate revenues. But when the discriminating tariff was continued in force, it was found that, year by year, more and more business centred at the points of competition. Every new manufacturing establishment, new business ventures of every kind, and consequently population, sought such localities as a matter of course. Statistics show that the entire net increase of population from 1870 to 1890, twenty years, in Illinois, Wisconsin, Iowa, and Minnesota (except the new section, which has not yet felt the effects of discrimination), was in cities and towns possessing competitive rates; and further, that all the non-competitive towns and villages decreased in population. Thus it happened, as time passed, that the depleting effect of these methods upon the railway treasuries became more apparent as the population and business of competitive points increased, and the relative population and business of the non-competitive territory decreased. . . .

In later years, various influences have had a share in the development of these competitive tariffs. The larger part of the everyday actions of mankind is controlled by habit or custom rather than by thought; by imitation, as parrots' talk, rather than by the laborious methods of reasoning out conclusions from fundamental principles. Hence, by far the greater number of minds possess that quality which, for want of a better name, may be called conservatism; that is, the habit of thinking everything good that is old, and everything right that is established. Methods which had once become established, in process of time came to be regarded as correct. After they had continued for a long time, there was apparently a very strong argument in their favor, because, relying upon them, various manufacturing and important business investments had been made, which would become less valuable, and in some instances valueless, if the rule were changed; and hence to return to an impartial tariff would, in a sense, do injustice. This argument has had, and possibly ought to have, great weight.

Returning to the influence which custom has, even upon the minds of practical men, it may be noted that, after an extremely low rate has been in effect a sufficiently long time for it to become familiar, it gradually comes to be regarded, if not as standard, at least as a level which it is safe to reach in order to meet an emergency. For example: the rate of seven and one half cents per hundredweight on flour from Minneapolis to Chicago, four

hundred and ten miles by the shortest line, which gives an average of only about three mills per ton per mile, less than half the average cost of transportation, in the minds of the people, and even in the minds of the traffic officials, is beginning to be regarded as a fair rate. The soliciting freight agent, in his mad chase after tonnage, has this precedent always in mind. The shippers of other commodities reason that if the railways can afford to carry flour and wheat at that rate, they can surely carry other things at comparatively low rates. Indeed, it is difficult to explain why corn, oats, coal, etc., all being of less value, and able to be handled with equal facility, should be charged a higher rate than wheat and flour. Here again is seen the strong tendency of the lowest rate to drive out the higher, and to become the standard rate.

In every other business, and in every department of the railway business except the traffic department, mathematics plays a conspicuous part. The merchant and manufacturer calculate their profits by percentages on the cost price. The engineer, in constructing a railway, recognizes the fact that all curves are composed of tangents, which bear fixed mathematical relations to each other, which must be observed, and that his gradients must be carefully and mathematically worked out and measured. The superintendent, in making out a time card for running his trains, recognizes the necessity of mathematical accuracy, for the question as to where and when two trains shall meet cannot be guessed at or left to chance. But in the traffic department it is different. The average traffic officials may truthfully be said to detest mathematics as the "devil does holy water." They boldly say that it is impossible to make a tariff of rates based on strict mathematical principles, like a time card for running trains. This prevailing idea is probably based upon the fact that, with their limited mathematical knowledge, they are aware of no method of reaching similar results without such infinite labor as staggers the human mind to contemplate, or possibly upon the further fact that, as the business is now conducted, such schedules would evidently be useless. An inspection of the present tariff will therefore show no relative values between the rates or between the classes of freight. A class or commodity which is rated higher than some other class or commodity at one station, at the next station may have changed positions, and be rated lower.

It would seem that, in naming rates, traffic officials regard each rate as isolated, holding no fixed relations to others; hence, in

preparing schedules, it is thought that any arbitrary figures which may be agreed upon can be enforced, provided the companies keep faith with each other. Reasoning from these premises, they have organized associations for the purpose of agreeing upon rates. The fact that these associations have accomplished so little towards maintaining the rates thus agreed upon would seem to indicate that the premises are false. . . .

Another powerful influence in the development of competitive tariffs is the large number of persons who have been entrusted with autocratic power to make rates. The treatment of rates separately, and as bearing no mathematical relation to each other, necessarily makes the detail labor of the traffic department so prodigious that it is altogether beyond the physical ability of any one man. In working out the printed rates alone, the mass of figures is so voluminous that no human intellect can grasp them. To illustrate this point, it may be stated that the number of separate printed tariffs in legal effect on a large system at any given time may be approximately estimated at three thousand, some of them containing thirty or forty large-size pages of solid columns of closely printed figures. It goes without saying that under such circumstances this work must be left to subordinates and clerks; and while they are all issued under the signature of the chief, as a matter of fact he has examined but few of them, and such examination as he is able to make is of a most cursory character. Taking these facts into consideration, and remembering the further practice which has come into vogue of meeting "not only the cut rates that have been made, but also those that it is thought probable or possible will be made by rival companies," and of doing this quickly on the spot, it will not be difficult to understand how large a number of persons must be entrusted with the high prerogative of making rates, as well as how the chaotic condition of the tariffs comes about.

In a work of this kind it is hardly possible to enumerate all the influences which have been effective in the development of these tariffs, but it is desirable to mention at least two more. The power of large shippers to combine and offer their business for sale as a whole, in order to secure lower rates, or to give it to one out of several competing lines as a sort of offset to any attempt of managers by combination to increase hitherto unprofitable rates, has had a most important influence of late years. The enactment of the so-called Interstate Commerce Law is the only other influence

that can be brought into comparison. The immediate and marked effect of the law was the leveling of certain intermediate and non-competitive rates to the standard of the low competitive rates, which is another illustration of the tendency of all rates to seek the low rates as the standard.

Having set forth some of the more important influences which have been actively at work for more than twenty years in evolving a schedule of competitive rates, it seems proper that this chapter should end with a presentation of the tariff which has been evolved. For this purpose Diagram No. 3 [Plate 7] has been prepared, which

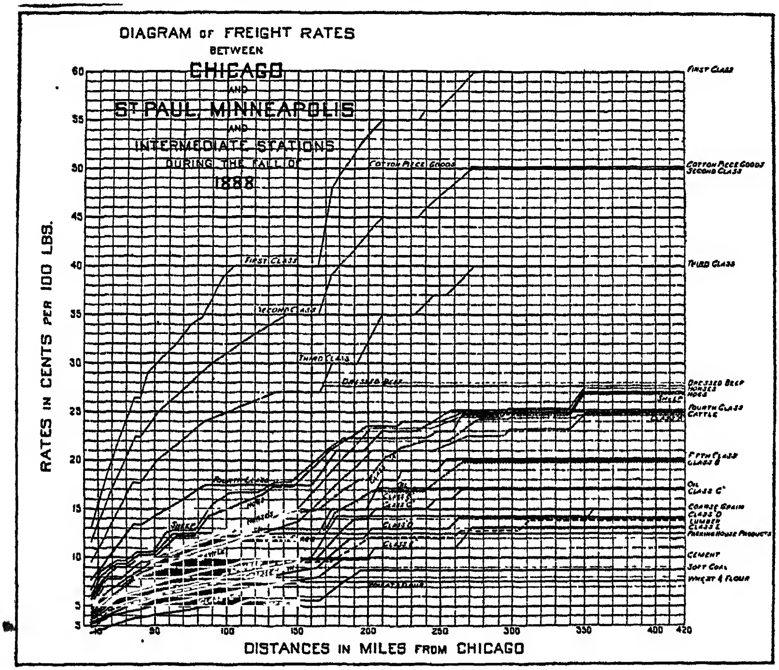


PLATE 7, DIAGRAM NO. 3.

accurately represents the published legal tariff which existed on one of the lines (and practically on all) between Chicago and Minneapolis (420 miles), in the autumn of 1888, after the Interstate Commerce Law had gone into effect. It is freely charged in railway circles, and presumably it is true, that since that date the custom of paying rebates to individual shippers, to which the terrors of the Interstate Law at first seemed to put an end, has again come into vogue, so that even many of the rates shown on the diagram,

low as they appear, are not in use, having been driven out by the lower rates.

For those who will take the trouble to study the diagram critically, and reflect upon its significance, it will prove an interesting light upon the question under consideration. The first thing that will strike the mind is, that the schedule must have been the result of chance, for no ingenuity could have planned such a snarl. It will also be noticed that most of the rates are the same for a haul of 250 miles as for one of 420 miles. This level line of rates between the 250 and 420 mile points is due to the operation of the "long and short haul clause" of the Interstate Commerce Law. Previous to the enactment of the law these intermediate rates were higher than at the two points mentioned.

The rate on flour and wheat is the same for 80 miles as for 420 miles, the line being level between these two points; on coal it is the same for 200 miles as for 420 miles; on cement, the same for 120 miles as for 420 miles; on coarse grains, which include corn, oats, barley, etc., from the 180th mile to the 420th mile it is almost twice as much as that on flour and wheat. The rate on soft coal for a haul of from 10 to 180 miles is lower than that on flour; from that point on to 420 miles, it is higher. The rate on class E, 70 miles' haul, is less than six cents, while on packing-house products for the same distance it is more than twice as much, or twelve and a half cents; but for the 420 miles' haul class E rate becomes the highest. For 140 miles' haul class E rate is lower than the wheat and flour rate, the cement rate, the packing-house produce rate, and the lumber rate; but before it reaches the 420 miles' haul it has gone above all of them.

Compare class B with fifth class, and for 110 miles class B is lower; for the next 50 miles it is higher; for the next 10 miles lower; then for 30 miles higher; then for 50 miles considerably lower; then for 160 miles the same. But why enumerate what the diagram shows at a glance?

If any one wishes fully to understand the chaos of rates, let him imagine at each important town numerous merchants and manufacturers having special secret rates, each believing he has the lowest, and all but one probably being fooled in that respect, and then the diagram, in connection with his imagination, will partially illustrate the facts in existence. Could anything be more unreasonable and inconsistent, and is it any wonder that the managers, by agreement or otherwise, are unable to maintain and enforce such a tariff?

CHAPTER IX

EQUALIZATION AND COMPETITION[1]

1. Mississippi River Crossings[2]

Harlan, *Commissioner:*

For many years the communities on the Mississippi River between Dubuque on the north and St. Louis on the south have been divided into two groups known as the upper and lower crossings. Disregarding one or two small points having no importance in this inquiry, the upper crossings for our purposes here may be said to include Keokuk, Fort Madison, Burlington, Muscatine, Davenport, Clinton, and Dubuque, all of which are in the state of Iowa. There is no bridge at Muscatine, but it is on the west bank of the river and takes the upper crossings rates. The lower crossings are St. Louis, Louisiana, and Hannibal, in the state of Missouri, and Quincy, the latter being on the east bank of the river, in the state of Illinois.

The complaint was brought in behalf of the upper crossings on the west bank of the river. They demand a parity of rates with St. Louis on all traffic coming from or moving to points east of the boundary line between the states of Illinois and Indiana. The general allegation is that the rates of the upper crossings, both westbound and eastbound, are in themselves excessive and un-

[1] On the subject-matter of this chapter, see Vanderblue and Burgess, pp. 118–138.

[2] *The Mississippi River Case,* 28 I. C. C. 47 (June 17, 1913). This was one of a group of cases which involved practically all the rates under which traffic moved into and out of the state of Iowa. The other cases brought in question the reasonableness and general propriety of the rates between towns and cities in the interior of the state and points east of the Indiana-Illinois state line; the rates between interior Iowa and Chicago and Peoria; and the rates between interior Iowa and certain points in the states to the west, northwest, and southwest. The manner in which these rates were constructed put Iowa, it was alleged, on a rate level well above its neighbors, retarded its development, and tended to isolate that state commercially. The complaint under immediate consideration attacked the rates between the Mississippi river towns in Iowa and the East. It was taken up first because, from the Commission's understanding of the whole situation, it was desirable to reach a proper solution of the issue there before entering upon a consideration of the rates in controversy in the other cases:—*Interior Iowa Cities Case,* 28 I. C. C. 64, and 29 I. C. C. 536; and *Cedar Rapids Commercial Club* v. *Chicago, Rock Island and Pacific Railway Company,* 28 I. C. C. 76. The adjustment of rates into Iowa is further discussed at length in *Railroad Commissioners of Iowa* v. *Ann Arbor Railroad Company,* 46 I. C. C. 20.—Ed.

reasonable, and are also discriminatory when compared with the more favorable rates enjoyed by the lower crossings. After the first hearing was had, intervening petitions were filed by certain commercial organizations at Keokuk, Fort Madison, Muscatine, Davenport, and Dubuque. While these petitions in terms adopt the allegations of the complaint and therefore question the reason-

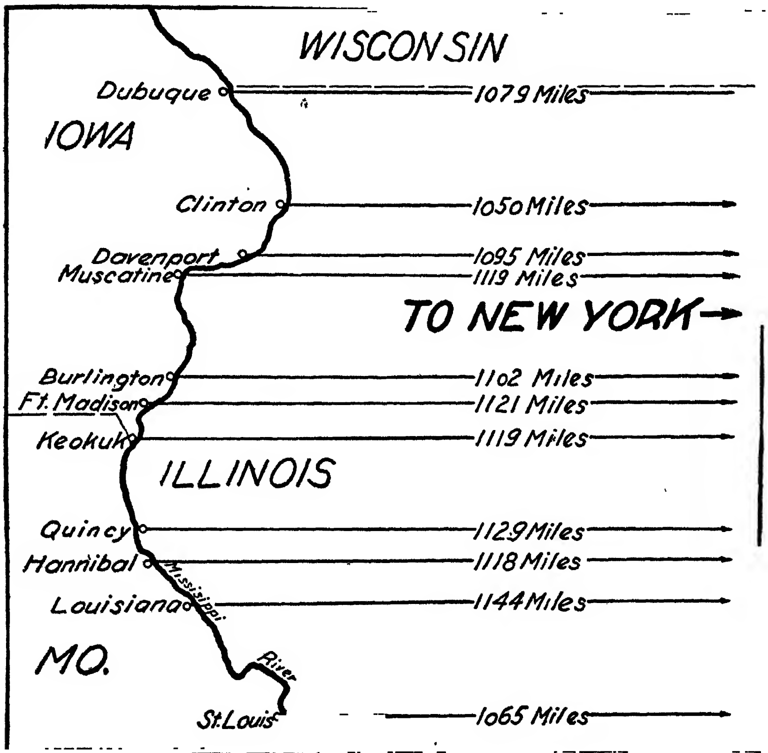


PLATE 8.—Mississippi River Crossings.

ableness of the rates, they also set up the specific allegation of a discrimination in rates against the upper crossings in that they are required to pay a bridge arbitrary on inbound traffic from the east, while the lower crossings pay no such arbitrary, either on inbound traffic from the east or on outbound traffic to the west, and at the same time have the advantage of the same distributing rates to the west that are available to the upper crossings. . . .

The accompanying map, reproduced from the brief of counsel for complainants, indicates that there is no great disparity in dis-

tance from the seaboard to the various crossings. Clinton, one of the upper crossings, is nearest to New York City. Its short-line distance is 1,050 miles, as against the short-line distance of 1,065 miles from New York City to St. Louis. These are the War Department mileages, although by the Pennsylvania lines St. Louis seems to be 1,053 miles from New York City. The most distant of the upper crossings is Fort Madison. It is 1,121 miles from New York City, as compared to a haul of 1,129 miles from the same point to Quincy, a lower crossing, as the distances are shown on the map. The average distance of the four lower crossings is 1,114 miles, while the average distance from New York City to the seven upper crossings is 1,098 miles. It should be said, however, that the great bulk of the traffic to the lower crossings is destined to St. Louis, which is 1,065 miles from New York City. The traffic to the upper crossings is more or less equally distributed, Muscatine and Fort Madison being relatively less important.

The west bank of the Mississippi River is the west boundary of what is called the percentage zone territory, and all the crossings, both upper and lower, are under the percentage basis of rates with respect to traffic to and from points east of Buffalo and Pittsburgh. That rate system is described in *Saginaw Board of Trade* v. *G. T. Ry. Co.*, 17 I. C. C., 128, and is so well understood as to require no further explanation at this time.[1]

In the sense here intended St. Louis was not put into the percentage basis territory until 1908. Prior to that time the western boundary of the territory was on the east bank of the river at that point. East St. Louis was then in the 116-per-cent zone, and the rates to St. Louis were made by surcharging the East St. Louis rates with a bridge arbitrary on a 1-cent scale; but the toll taken out of the rates for the bridge service was on a 3-cent scale. As the result of negotiations between the merchants of St. Louis and the eastern lines, East St. Louis and certain adjacent towns in Illinois were grouped on January 2, 1908, with St. Louis, and all were erected into a new zone taking 117 per cent of the Chicago rates. In this way and at that time St. Louis was first made a definite rate point in that its rates were no longer based on the East St. Louis rates; it was then given its own class rates from New York on the 88-cent scale. These rates, it will be observed, take the traffic across the river with no additional charge in the

[1] See Jones, pp. 148–157; Vanderblue and Burgess, pp. 131–132, 191–196; and especially *Michigan Percentage Cases*, 47 I. C. C. 409.—Ed.

way of a bridge toll. In the readjustment East St. Louis lost the advantage of being a 116-per-cent point, its class rates from New York being increased from the 87-cent to the 88-cent scale. The same class rates were extended to the remaining lower crossings at Louisiana, Hannibal, and Quincy; but we need not follow the details of the development of the rates at those crossings further than to state that the Burlington forced the situation and assigned the requirements of the fourth section as the explanation.

The history of the rates from New York to the upper crossings is also explained of record. Prior to 1889 the class rates to those crossings seem to have been adjusted on the basis of 125 per cent of the Chicago rates plus a bridge arbitrary of 5 cents. At that time Keokuk was the terminus of one of the branch lines of the Wabash; and this company, during that year and while under a receivership, reduced the rates to a basis of 122 per cent of the Chicago rates, adding a bridge arbitrary. This action was promptly met by the Toledo, Peoria & Western; and the other western lines were soon compelled to adopt the same basis in order that the jobbers at their crossings might be on a rate parity with Keokuk for merchandising into the interior of Iowa. Davenport on the west bank had theretofore been grouped with Moline and Rock Island on the east bank, with respect to traffic to the interior of Iowa and points beyond, and in the readjustment these two points on the east bank were given the lower class rates, with the bridge toll added, and thus were kept on a parity with Davenport.

Rates constructed on the basis of 122 per cent of the Chicago rates would give the upper crossings a 92-cent scale of class rates from New York City; and as a matter of fact the 92-cent scale is published in the tariffs of the carriers as the rates to points in the 122-per-cent zone. Those rates, however, do not take the traffic across the river, as is the case with the 88-cent scale at the lower crossings. They do not, in fact, take the traffic even to the west bank of the river. A toll is added to effect that result. The zone which embraces the Iowa crossings on the west bank of the river is shown on the percentage map not as a 122-per-cent zone, but as "122 per cent, plus." The "plus" refers to the bridge arbitraries, which, under a tariff note, must be added to the 122 per cent, or 92-cent scale of rates in order to make the rates for that zone. These arbitraries are as follows:

Classes	1	2	3	4	5	6
Bridge tolls	5	5	5	4	3	2

In this manner the present class rates to the upper crossings, and to all other points in the so-called "122 per-cent-plus" zone, are actually made on a 97-cent scale and not on the 92-cent scale. Although expressly published as such, the western lines out of Chicago assert that these arbitraries can not properly be considered as bridge tolls, not being added to the 92-cent scale as compensation to the western lines for handling the traffic across the bridges spanning the Mississippi River, but simply to make a basis for the difference between the rates to those crossings and the rates to the lower crossings. Although published as separate charges to be added to the 92-cent scale of rates, this is done, as the carriers say, merely because the aggregate charges thus constructed are not made or joined in by the eastern lines. This view of the matter is supported by the fact that the so-called "122-per-cent-plus" zone reaches well back into Illinois and fixes the rates on the traffic of points in that state upon which no bridge service is performed at all.[1]

But whatever may have been the reason for so publishing the rates, a comparison of the aggregate charges on class traffic to the upper crossings with the class rates to the lower crossings shows a rate advantage in favor of the latter as follows, taking New York City as typical of the whole Atlantic seaboard:

Classes	1	2	3	4	5	6
Upper crossings	97	84	66	47	40	33
Lower crossings	88	76	59	41	35	29
Difference	9	8	7	6	5	4

These discriminations against them, the upper crossings contend, are too great a burden to carry and make their freight charges both unreasonable and unduly discriminatory; and they offered much evidence in support of their prayer for a parity of rates with the lower crossings. While Quincy has not grown, perhaps, as rapidly as some of the upper crossings, the complainants point to the general prosperity of St. Louis and Hannibal under their more favorable rate adjustment. There is also testimony of record tending to show that the Iowa cities have met with difficulties in their effort to secure the location of new industries at the several crossings, and that in some instances they have found it difficult even to retain the industries that are now estab-

[1] See *Chamber of Commerce of Freeport* v. *Chicago, Milwaukee and St. Paul Railway Company*, 33 I. C. C. 673.—Ed.

lished there. Indeed, mention is made of a number of companies that have removed from Keokuk and other river points in Iowa to locate elsewhere because of the discrimination against them in the rates. Advertisements were introduced of record in which Quincy and St. Louis, in their efforts to secure new industries, have set forth their claims from a rate standpoint as compared with the upper crossings. The complainants speak of this as a "cold-blooded" way of taking advantage of an improper rate adjustment. As a matter of fact, Quincy is reached by no eastern carrier and has a two-line haul. Its distance from New York exceeds that of any other of these crossings except Louisiana, which is also a lower crossing reached only by western lines but nevertheless enjoying St. Louis rates. Moreover, Quincy is only 31 miles south of Keokuk, a fact that is emphasized by the complainants as indicating the manifest injustice of the difference in the rates enjoyed by the two communities. If there is any dissimilarity in conditions, as between Quincy and Keokuk or the other Iowa crossings, the complainants strongly assert that the difference is in favor of the Iowa towns.

On behalf of Keokuk a mass of exhibits and some testimony were presented. The water power in process of development there involves an expenditure of $25,000,000 and will produce about 200,000 horsepower. Although Keokuk's location on the river and this large power at its door give promise of a great city, its citizens feel that the present handicap in freight rates is such as to make it impossible to attract new industries there, the advantage of cheap power being more than offset by the disadvantage in the rates. Keokuk is therefore demanding with great earnestness the same basis of rates that is now available to its neighbors at the lower crossings, and particularly at Quincy, only a few miles distant. The advantages of the water power of Keokuk, of its geographic location, and of its shorter mileage are all destroyed, it is contended, by the present unnatural rate adjustment.

The other upper crossings are asking no less earnestly for a rate parity with the lower crossings; and in support of their contentions several arguments are advanced. Their first proposition rests on the fact that the Missouri River crossings are grouped with respect to traffic from the east, while the Mississippi River crossings, although approximately covering the same extent of territory from north to south and with approximately the same differences in mileage from the east, are not so grouped. As a matter of

fact, from New York the extreme difference in distance as between all the Mississippi River crossings is less than the extreme difference in distance as between the Missouri River crossings. Another point urged with some vigor is the fact that, with respect to traffic originating at or destined to the Pacific coast, Spokane, Utah common points, Oklahoma common points, and points in Colorado, Nebraska, and Kansas, or, in other words, substantially all the great territory west of the Missouri River, the upper crossings are grouped with St. Louis in disregard of any differences in mileage, which as to some points favor St. Louis, but in many, if not in most, cases favor the upper crossings.

The charge of unjust discrimination against the Iowa crossings and the resulting undue preference of St. Louis and the lower crossings is supported by much testimony; it is the main feature of the controversy and demands careful attention. To use the language of counsel for complainants, the present rate adjustment in favor of St. Louis on traffic originating in the east—

> creates a combination of rates in every instance against the Iowa cities * * * * to any point west of the Missouri River. This all tends to circumscribe the business activities of the Iowa cities, and when they are able to compete with Quincy and St. Louis it is because of special ability or some other factor so superior to that possessed by the merchants of the Missouri cities as to effectually offset the constant handicap in freight rates.

This discrimination is not justified, as the complainants assert, by any differences in circumstances or conditions affecting transportation. The nature of the routes, the prosperity of the various carriers, the density of their traffic and other transportation conditions are discussed of record, and the complainants contend that there is nothing in these matters that makes against their demand. Many exhibits were offered in behalf of the Iowa cities, the result of which is a demonstration of the fact claimed, namely, that to this great western territory the combination of inbound and outbound rates favors the lower crossings as against the Iowa crossings by substantial amounts. A single example of this will suffice to illustrate the general situation. The first-class rate under the official classification from New York to St. Louis is 88 cents and to Keokuk 97 cents. The first-class rate from all the crossings to Lincoln, in the state of Nebraska, is 65 cents.. The aggregate charge to the jobber at Keokuk is therefore $1.62, while the aggregate charge to the jobber at St. Louis is $1.53, with no great differ-

ence in mileage. A part of this discrimination, as is said, lies in the bridge toll added on inbound traffic at the upper crossings, the inbound traffic of the lower crossings not being so burdened. The traffic even of Quincy, which is on the east bank and, as stated, is also a lower crossing, when moving outbound on merchandising rates, crosses the river without paying a bridge arbitrary. Examples might be multiplied of this rate inequality between the upper and the lower crossings with respect to the combination of inbound and outbound rates upon which jobbers conduct their business. Of course, as to many kinds of merchandise, this disadvantage against the upper crossings is not a practical one, for jobbing houses at those points can not in any event strongly compete in the territory west of the Missouri River with jobbing houses on the Missouri River. It was shown, however, that in the case of some merchandise, such as shoes, overalls, etc., the higher charges do actually curtail the activities, in the territories west of the Missouri River, of the commercial houses at the upper crossings.

Considering all that is disclosed of record with respect to the mileage to the several crossings, the general conditions affecting transportation to and from and through them, the geographic location and the commercial activities of the upper and lower crossings, we think a rate situation is presented that requires some explanation and justification by the carriers if it is to be further maintained. In fact, a rather clear prima facie case is made by the mere recital of the facts. The thought is stated in that form because, in the consideration of the several complaints coming before us during the past few years in which this general rate structure has been brought to our attention, it has become increasingly evident that the fact that this relation of rates, as between the upper and lower crossings, has been in effect for a number of years would not alone justify its continuance for the indefinite future. Time has an undoubted weight in rate matters. It may often be controlling when a rate in daily use has been accepted by shippers for some years without criticism or complaint. This may perhaps be said even more strongly of a relation of rates under which different communities have competed with one another for some years. But time can not be permitted to rob a group of communities of their right to relief from what, in view of changed conditions, will be a manifest rate discrimination if further continued.

There has, of course, been no change in the geographical rela-

tion of the upper to the lower crossings; but in the conditions affecting transportation there has been a great change in recent years. In addition to the direct evidence of record on the point we may draw upon the recent history of that part of the country. The census shows a very rapid and large increase in population at Seattle, Portland, Spokane, and other towns in the northwest which have reached the magnitude of cities in the last few years. There has also been a rapid growth in agricultural and industrial development in those states and in the entire territory west of the Missouri River. The tonnage over the direct routes to all the Mississippi River crossings has therefore undoubtedly grown to be very large. But the point that we are endeavoring to emphasize is not that there is a greater density of traffic over the upper crossings than over the lower crossings or vice versa, but rather that over all the routes to all the crossings the density of traffic has become so great as practically to absorb and take that factor out of the discussion as a basis for any substantial difference in the rates as between the upper and lower crossings. Moreover, the defendants compare the traffic density of the eastern lines as systems, meaning those reaching Chicago and St. Louis, with the density of traffic over the lines west of Chicago. The comparison is, of course, unfavorable to the latter carriers, and the defendants contend, therefore, that the rates to the upper crossings may properly be higher than the rates to the lower crossings. We cannot accept this, however, as a conclusive basis for comparison. So far as density may be regarded as a substantial element in this rate situation, the density over the routes by which the traffic moves would be a more persuasive basis for the comparison, whether those routes are made up wholly of eastern lines, as in the case of the routes to St. Louis, or are composed of the eastern lines together with the western lines, as to most of the upper crossings. The exhibits of the defendants show the density of traffic only by systems and by territories. In our judgment the comparison, to have any controlling value in the consideration of these rates, ought more or less to be limited to the traffic density over the direct routes to the various crossings. So considered we are unable to find from the record that St. Louis and the other lower crossings now have any very material advantage in density over the routes to the upper crossings.

A careful study of the record in respect to the various matters hereinbefore adverted to leads clearly and strongly to the conclu-

sion that the present relation of rates as between the upper and lower crossings no longer fits the conditions surrounding the traffic, and that the complainants, as we have indicated, have made out a prima facie case which the carriers must meet if the present adjustment is to continue. Let us therefore see what the defendant lines have to say in support of the present adjustment.

Their principal defense is that the circumstances and conditions surrounding the movement of traffic to and from the upper crossings differ substantially from the circumstances and conditions surrounding the traffic to and from the lower crossings, and warrant a higher level of rates to the cities in Iowa on the west bank of the Mississippi River. They assert that there are substantial differences in the character of the routes, in the density of traffic over the several routes, and in the conditions of competition and operation affecting the traffic moving over them to the several crossings. They point out, for example, that the eastern lines took no active part in this proceeding and that those lines, reaching St. Louis with a one-line haul, determine the basis of rates to that point, while the western lines, reaching the Iowa cities on the west bank of the river, have no voice whatever in fixing the rates between St. Louis and the east, although some of them participate in St. Louis traffic moving by way of Chicago. On the other hand, as the defendants contend, the rates of the Iowa crossings are made by the eastern carriers in conjunction with the western lines, and apply to what is a two-line haul as against a one-line haul to St. Louis. As a matter of fact, however, St. Louis is the only one of the lower crossings that can claim a rate advantage by reason of a one-line haul. The other three lower crossings, namely, Quincy, Hannibal, and Louisiana, are reached from the seaboard only over two-line routes. But they nevertheless take the St. Louis rates.[1] On the other hand, Keokuk and Burlington are reached by the rails of the Toledo, Peoria & Western, which, at Effner, Ind., joins the rails of the Pennsylvania lines, by which it is owned in conjunction with the Burlington. The complainants therefore contend that if any advantage is to accrue to St. Louis by reason of its so-called one-line haul the same advantage belongs to Keokuk and Burlington, if the Toledo, Peoria & Western be considered as a part of the Pennsylvania system. They think it should be so considered because the rails

[1] In *Class and Commodity Rates to and from Quincy*, 32 I. C. C. 471, and 33 I. C. C. 409, the Commission considered these adjustments.—Ed.

of the Pennsylvania, the New York Central, and the Baltimore & Ohio, the so-called one-line routes to St. Louis, are operated west of Buffalo and Pittsburgh by separate corporations, namely, the Vandalia, the Big Four, and the Baltimore and Ohio Southwestern, and yet these lines are claimed by the defendants to be one-line routes to St. Louis.

The second respect in which the defendants allege a difference in transportation conditions over the several routes to the various crossings is in the matter of traffic density. The testimony offered by the complainants on that point is said by the defendants to be entirely insufficient. In the foregoing pages we have criticized the tonnage statistics of the carriers as not being sufficiently concrete and definite to prove anything of real value respecting these rates. Without going over that ground again it will suffice to say that while the St. Louis lines perhaps have some advantage in this respect, it is not large enough to be very material, and certainly not large enough to justify the present advantage in rates that St. Louis and the lower crossings have over the Iowa cities on the west bank of the river.

Another point upon which no small stress is laid by the defendant lines is that on movements to the Iowa crossings a transfer or rehandling is required at Chicago, Peoria, or other gateways, whereas movements from the east to St. Louis are handled through to destination without a transfer or any rehandling. We do not understand that carload freight destined to the upper crossings is ordinarily transferred at Chicago or at the other gateways; and on general principles there ought not to be any necessity for such a transfer except in unusual cases. In any event, the fact that this may be necessary at times, or even frequently, can not justify a difference in the rates on a 9-cent scale, when the length of the haul and most of the other conditions affecting transportation are approximately similar. A large part of the less-than-carload traffic is rehandled or transferred at Chicago and other junction points, and in any final conclusion as to what is a proper relation of rates as between the upper and lower crossings this fact ought not to be overlooked.

No definite figures are given by the carriers as to the effect on their revenues of an order putting the upper crossings on a parity with St. Louis, but it is claimed that the result would be severe. In addition to its direct results the application of the 88-cent scale to those crossings would force a reduction in the through charges

to practically the entire state of Iowa. Under the requirements of the fourth section reductions would also follow in the rates to Freeport, Sterling, Dixon, Monmouth, and many other towns in Illinois now in the 118, 120, and 122 per cent groups.[1] The effect would probably extend to northern Missouri, southern Minnesota, and southern Wisconsin.[2] In the aggregate the loss in revenue undoubtedly would be very substantial. This is earnestly pressed upon our attention and is a matter requiring due consideration. In that connection it is said by counsel for the defendants that low freight rates necessarily mean an inferrior service because, in the absence of a revenue sufficient to enable the carriers properly to maintain their lines and to have adequate facilities and sufficient equipment, the service of the defendants must necessarily suffer. What the complainants really need, in the judgment of counsel for the carriers, is railroads with full equipment, enlarged facilities, and a better service; and this they think the shippers should endeavor to secure rather than to cripple the facilities of the carriers and make their service inefficient by insisting upon lower rates.

There is of course no small force in the general proposition that just at this period of our commercial development increased facilities, a more extensive equipment, and a better service are more important to the general shipping public than a reduction in freight charges. This is being pointed out to us by shippers as well as by carriers. But this view necessarily can not appeal strongly to communities that are directly competing with other communities and wish to grow and expand and enlarge their trade, but find the door to opportunity partly closed and their favorable geographic location substantially discounted by effective discriminations in their rates. And the objections and protests against such a rate structure become still more aggressive when it more or less affects the commerce of an entire state. . . .

Upon a careful consideration of the whole record we find that the class rates to and from the upper crossings are excessive and unreasonable and that there is an undue and unjust discrimination both in the westbound and the eastbound rates of the upper crossings when compared with the more favorable rates enjoyed by

[1] In *Chamber of Commerce of Freeport* v. *Chicago, Milwaukee and St. Paul Railway Company*, 33 I. C. C. 673, the Commission placed Freeport upon the 114 per cent basis and Rockford upon the 112 per cent basis.—Ed.

[2] These adjustments have been considered by the Commission: *Wisconsin Rate Cases*, 44 I. C. C. 602; *North Iowa Traffic Association* v. *Director General*, 58 I. C. C. 491; and *La Crosse Chamber of Commerce* v. *Ann Arbor Railroad Company*, 61 I. C. C. 289.—Ed.

St. Louis, Quincy, and the other lower crossings on Atlantic seaboard traffic. Whatever may have been the case some years ago, we find no such differences at this time in the circumstances and conditions surrounding the traffic or affecting the carriers as will justify the further continuance of the discrimination, at least in the degree and to the extent to which it now exists, or that will justify the continued maintenance of the present rates. Taking all things into consideration, much can be said, and much has been said on the record by these complainants, in support of the contention that there should be a parity of rates from the seaboard as between St. Louis and the Iowa towns on the west bank of the river; and we should be disposed to require such a parity of rates to all the crossings if the rate situation could be considered abstractly on the record and without regard to the effect elsewhere and upon other rates. That, however, would not be so broad a view of the matter as the circumstances require. We can not put out of sight the discriminations and inequalities that would result from such an order; on the contrary we must look at the whole situation and in that manner arrive at substantial justice. Moreover, the effect of such an order and of so radical a change in a rate structure of this importance would be far-reaching; it would not only profoundly disturb the communities immediately involved, but would disturb other communities, and at the same time result in a drastic reduction in the revenues of the carriers. As a regulating body, we can not overlook such consequences.

The facts of record do not suggest the propriety of allowing an increase in the rates of the lower crossings. On the contrary, we have found that the rates of the upper crossings are excessive. It follows, therefore, that if a parity of rates is brought about in the future in either of the ways mentioned, it must be reached through a reduction in the rates to the upper crossings. Nevertheless, an order at this time putting the upper crossings on the St. Louis rate basis would be so serious in its effect upon the revenues of the respondents that we are constrained to modify the conclusion that we otherwise might reach. We think that some weight may be, and under all the circumstances should be, given to the fact that most of the traffic to the upper crossings moves over a two-line route. There is, of course, no fixed rule of transportation requiring a higher rate for a two-line than for a one-line haul of the same distance; as a matter of fact a two-line haul saves each of the participating carriers one terminal service. On

the other hand, a one-line haul is highly desirable in that it gives the one carrier all the revenue. But not infrequently, where a carrier must divide its revenue with a connection, we have recognized the propriety, under the special conditions shown, of a higher through charge. We think recognition may properly here be given to the fact that on almost the entire volume of traffic to the upper crossings two or more carriers share in the revenue. We must not forget also, as hereinbefore noted, that a large part of the less-than-carload traffic to the upper crossings is transferred at Chicago or at some adjacent gateway, and that the St. Louis routes apparently have a slight advantage in density. With all these considerations in mind we find upon the record that there is in the present adjustment an undue and unjust rate discrimination against the upper crossings which ought to be modified by a reduction in the rates to those crossings. Testing the present rates of those crossings eastbound and westbound, by the rates voluntarily made by the carriers for the lower crossings and by all other facts of record, we also find that the rates to and from the upper crossings are excessive and unreasonable, and that any rates between New York City and the upper crossings will be unreasonable when in excess of the following scale of class rates, which we prescribe as maximum rates, in cents per 100 pounds, for the future:

Class	1	2	3	4	5	6
Rate	90	78	60	42	36	30

The rates from other points in eastern territory will be adjusted on the present relation of those points to New York City under the present rates. There are slight differences between the eastbound and the westbound rates, but we find no basis of record for preserving this difference in the future; we therefore fix the same rates on eastbound as on westbound traffic.[1]

[1] On April 1, 1914, the first-class rate to the upper crossings was fixed at 90 cents as compared with 88 cents to the lower crossings. On December 29, 1914, the Commission (apparently of the opinion that advances authorized in *The Five Per Cent Case*, 32 I. C. C. 325, had overcome the reasons which prompted it to approve a spread between the lower and the upper group cities) entered an order requiring that all those cities, in their relation to the trunk line territory, be put upon a rate parity, thus making a straight rate line of the river with respect to trunk line traffic.

The equalization thus established has since been maintained, and the rates from and to the seaboard to and from the Mississippi River crossings are upon the same basis (117 per cent of the New York-Chicago rates).—Ed.

2. Proportional Rates on Grain [1]

Clark, *Commissioner:*

The complaint is that the present relationship of rates on wheat and corn and articles taking the same rates, as between Kansas City and Omaha, respectively, to the destinations named, is unduly and unjustly discriminatory against Kansas City and in favor of Omaha. No complaint is made that any specific rate is unreasonable, and no prayer is made for the establishment of any specific rates, but the demand of complainant is that the relative adjustment of rates on the commodities named as between Kansas City and Omaha shall be changed, and that there shall be a greater difference in the rates from Kansas City and from Omaha to those destinations than now obtains. . . .

Both Omaha and Kansas City are, and for a long time have been, what are commonly termed "Missouri River crossings." Generally speaking, rates on all classes of merchandise moving from the Mississippi River or points east thereof and north of the Ohio River are the same to both Omaha and Kansas City via any route leading to either. Rates eastbound from Kansas City or Omaha to the Mississippi River and points east thereof and north of the Ohio River, generally speaking, are the same via all routes and all Mississippi River crossings.

The rates on grain and grain products from Kansas City or Omaha to points east of the Mississippi River and north of the Ohio River are the same via all lines and crossings.

Under the present adjustment proportional rates on grain originating beyond Kansas City or Omaha are generally the same to St. Louis from Kansas City or Omaha, while to Cairo and other Ohio River crossings, to Carolina territories, and to Memphis, and to New Orleans, Galveston, and other Gulf ports for export, they are 1 cent per 100 pounds higher from Omaha than from Kansas City. Local rates from Omaha are 1 cent per 100 pounds higher than from Kansas City to St. Louis, 2 cents higher to Cairo and other Ohio River crossings, 2 cents higher to Memphis, 1 cent higher when for Carolina territories, and 1 cent higher to New Orleans, Galveston, and other Gulf ports for export.

[1] *Kansas City Transportation Bureau* v. *Atchison, Topeka and Santa Fé Railway Company*, 16 I. C. C. 195 (May 10, 1909). On the question of proportional rates, see *Baltimore Chamber of Commerce* v. *Baltimore and Ohio Railroad Company*, 22 I. C. C. 596, 600; *Lake Cargo Coal Rates*, 46 I. C. C. 159; *Nonapplication of Transit Privileges*, 69 I. C. C. 19; *Conference Rulings*, 170, 299, and 304. And see Vanderblue and Burgess, pp. 130–135.—Ed.

Kansas City is 137 miles nearer to St. Louis or Cairo than is Omaha, and is 194 miles nearer to Memphis, New Orleans, or Galveston than is Omaha.

On account of this difference in distance and the competition between them in purchasing grain in the grain fields, and in the sale of grain in the places and territories named, Kansas City complains that the equality of the proportional rates to St. Louis and the difference therein of but 1 cent per 100 pounds to the other points constitute unjust discrimination against Kansas City and in favor of Omaha.

Competition in the purchase and in the sale of grain is keen and active. Slight differences in cost or in price of sale decide the markets to which grain will go, and very slight differences in rates decide the routes over which it will move. Originally rates were made from various points of origin to markets farther east, and, under transit privileges, grain was permitted to stop at a primary market and in due time to be forwarded on the remainder of the through rate from point of origin. This resulted in a number of proportional rates from such primary market, which made the value of the grain uncertain and which created a great deal of controversy. After a time complaint against such an adjustment was filed with this Commission, and was later withdrawn under an understanding reached between the complainants and the carriers, which provided for the establishment on grain coming from beyond the Missouri River of one rate from the Missouri River to a given destination on or east of the Mississippi River and north of the Ohio River, regardless of the point of origin of the grain. This rate was called a "proportional rate." It was lower than the local rates on the same grain of the several carriers parties to the proportional rate, but, although called a "proportional rate" it has been, in effect, a flat rate, and the rate upon which the grain has moved from these markets.

When the Chicago Great Western Railway entered Omaha it established proportional rates on grain from Omaha to the Mississippi River the same as were in effect from Kansas City to St. Louis. This action led the lines reaching from Omaha to St. Louis to establish the same rates from Omaha to St. Louis and thus, in so far as proportional rates on grain and grain products from the Missouri River to the Mississippi River and points east thereof and north of the Ohio River were concerned, they were the same via the lines that lead directly east from Omaha to the

Mississippi River and that do not reach either Kansas City or St. Louis, via the lines that lead directly east from Kansas City and that do not reach either Omaha or the upper Mississippi River crossings, via the lines that lead from both Kansas City and Omaha to St. Louis and that do not reach any of the upper Mississippi River crossings, via the lines that reach from Kansas City and Omaha to both St. Louis and the upper Mississippi River crossings, and via the lines that reach from both Kansas City and Omaha to the upper Mississippi River crossings, and that do not reach St. Louis. The adjustment of rates on grain to the territory east of the Mississippi and north of the Ohio rivers is not attacked.

It is argued by complainant that Kansas City lies directly in the trend and direction of traffic from Omaha to St. Louis, Cairo, and the other Ohio River crossings, Memphis, New Orleans, and Galveston, and that therefore carriers have no right to disregard the difference in distance in favor of Kansas City. Complainant alleges that if the difference prayed for between the rates from Kansas City and Omaha to those points should be established by reduction in the rates from Kansas City the rates per ton per mile thereafter received for the transportation from Kansas City would exceed the rates per ton per mile now received on the traffic from Omaha to those points. No demand is made that the adjustment prayed for shall be effected by reduction of the rates from Kansas City. Complainant would be equally well satisfied if the difference were established by increasing the proportional rates from Omaha. . . .

Defendants and interveners show that competition in the grain fields is keen and close, and argue that the rate adjustment is such as to put Kansas City and Omaha on substantial equality in that regard.

Complainant contends that the local rates from the grain fields to Kansas City and Omaha are not in issue; that it is purely a question of the ability of Kansas City and Omaha to sell in competition with each other in the territory in question.

The present adjustment, under which the proportional rates from Omaha to St. Louis are the same as from Kansas City to St. Louis, was a compromise in 1904 in settlement of a rate war growing out of severe competition between carriers. It has been the subject of more or less dissension ever since. Complainant says: "It is not

fair—it is not one of long and peaceable standing." And we are almost led to the belief that there never can be an adjustment of grain rates that will be "of long and peaceable standing."

In *Traffic Bureau, Merchants Exchange of St. Louis* v. *M. P. Ry. et al.*, 13 I. C. C. Rep., 11, St. Louis interests complained of a rate adjustment on grain and grain products which gave Kansas City an undue advantage over St. Louis in Little Rock (Ark.) territory. There, it was shown that most of the grain going into that territory and handled either by St. Louis or Kansas City interests was drawn from the common territory west of the Missouri River, from which the rates to St. Louis were made on combination on the Missouri River, resulting in a combined rate from point of origin to Little Rock via St. Louis greater than via Kansas City. In some instances the rates from St. Louis to Little Rock were the same as from Kansas City to Little Rock, while there was a difference in distance in favor of St. Louis of 159 miles. In that case, it was said:

> If this case were to be decided without any reference whatever to competitive conditions at St. Louis and Kansas City it is clear that rates from St. Louis, by virtue of its greater proximity to Little Rock and Arkansas points, ought to be less than the rates from Kansas City.

And on the competitive question involved it was said:

> If the competitive conditions which do exist are to control, then these rates ought all the more to be less from St. Louis, since these two markets deriving their supplies largely from the same source compete in this territory, and therefore rates via the several lines from points of origin to final destination ought to be substantially the same.

An order was entered reducing the rates from St. Louis to Little Rock territory in order to bring about substantial equality of rates from points of origin to Little Rock in combination on St. Louis and in combination on Kansas City. Applying the same principles to this case, it would appear that the rates should be so adjusted that from points of origin of the grain to St. Louis, Cairo, and other Ohio River crossings, Memphis, New Orleans, Galveston, and other Gulf ports, they would be substantially equal from Omaha and from Kansas City, just as they are now substantially equal from Omaha and Kansas City to the upper Mississippi River crossings, and to territory east thereof and north of the Ohio River. . . .

The complaint in this case is supported mainly by argument as to distances. The distances from points of production to Kansas City and to Omaha, respectively, have been ignored except as some computations have been made on average distance. A proportional rate means a part of or a remainder of the through rate or it means nothing at all, and in a case of this kind there must be an examination and consideration of the entire rate from point of production to ultimate destination. It is not sufficient to consider the rates to an intermediate market, nor alone the rates from such market, if the question of discrimination between such markets is to be determined.

Tables of distances and rates from numerous Nebraska points show that in many instances the rate from point of origin is lower to Kansas City than to Omaha, while the distance to Omaha is materially less than to Kansas City.

These tables also show substantial equality of rates to destination points, based, apparently, upon a consideration of the total distance and the total rate. In other words, they appear to show that Kansas City is given credit for its shorter distance from the market in question by equalizing the through rates from points of origin to Kansas City.

For example, from Hastings to Omaha is 152 miles and the rate 11.9 cents. From Hastings to Kansas City is 296 miles and the rate 12.9 cents. From Hastings to Macon, Ga. (a point selected by complainant as illustrative), the distance via Omaha and St. Louis is 1,337 miles, and the total rate is 47.9 cents. Via Kansas City and Memphis the distance is 1,288 miles, and the rate is 47.9 cents. . . .

From Strang to Omaha it is 125 miles, and the rate is 11.05 cents. To Kansas City it is 245 miles, and the rate is 11.47 cents. To Macon via Omaha and St. Louis the distance is 1,310 miles, and the rate is 47.05 cents. Via Kansas City and Memphis the distance is 1,237 miles, and the rate is 46.47 cents. . . .

From Superior to Omaha it is 174 miles, and the rate is 11.9 cents. To Kansas City it is 268 miles, and the rate is 11.9 cents. To Macon via Omaha and St. Louis the distance is 1,359 miles, and the rate is 47.9 cents. Via Kansas City and Memphis the distance is 1,260 miles, and the rate is 46.9 cents. . . .

Complainant shows that from a large number of points of origin of grain in southern Nebraska the average distance to St. Louis is somewhat less via Kansas City than via Omaha and the

average rate to St. Louis somewhat less via Omaha. It is, however, to be remembered that the traffic of prime interest here is that which moves beyond St. Louis, and that the entire rate from point of origin to final destination is what determines the relative advantages of these markets. . . .

Another element of competition between carriers that must not be overlooked is the St. Joseph and Grand Island Railway, an independent line extending from Grand Island in southwestern Nebraska through southern Nebraska and northern Kansas to Kansas City, and with no line to Omaha.

The adoption of distance alone as a measure of the rates from points of origin to the primary market would necessarily result in a clear division of the territory between the markets, and would be destructive of competition in most of that territory. It would destroy the long-established adjustment which places Missouri River crossings substantially on a parity in both inbound and outbound rates on traffic generally. Giving to Kansas City all of the advantage that could come to it from a mileage adjustment would give it a monopoly of territory in which Omaha now freely competes with Kansas City, and the application of the same rule to Omaha would give it exclusive purchasing power in territory in which Kansas City now competes with Omaha on equal terms.

If that principle of rate making were adopted here, it would necessarily be followed in other places and eventually to other traffic, and while we are not to be understood as intimating that substantial differences in distance are not to be given consideration, we are not willing to accept the theory of rate construction based purely on distances. Such adjustment would be revolutionary and destructive to established commercial interests of enormous volume and value.

In *Farmers, Merchants, and Shippers' Club* v. *A., T. & S. F. Ry. et al.*, 12 I. C. C. Rep., 351, the Commission, in discussing the export rates via the Gulf ports versus export rates via Atlantic ports, said:

> This condition has of necessity been highly competitive. Eastern lines have extremely disliked to relinquish the traffic which they have enjoyed in the past and which they were built to enjoy, while the southern lines have found it necessary to obtain this traffic almost at the price of existence.

It is admitted that there is a necessary relation in the rates from both Omaha and Kansas City to the Atlantic ports on grain for

export. Therefore, if the rates on grain for export through the Gulf ports from Kansas City are reduced sufficiently to put out of balance the highly competitive and nicely adjusted relationship, it would no doubt provoke a corresponding change from Omaha eastward, which in turn would force a reduction from Kansas City eastward. The lines from Omaha through the upper Mississippi River crossings and that do not reach St. Louis, the lines which lead eastward from Kansas City to St. Louis and which do not reach the upper Mississippi River crossings, and the lines leading from Omaha to St. Louis which do not reach the upper Mississippi River crossings will, each of them, in protection of its own interests, see to it that its rates are as low and as favorable on grain from either Kansas City or Omaha to territories of large consumption or to export ports as the rates of any of the others. . . .

It is apparent that under the proposed arrangement the rate from Omaha to St. Louis would be 2½ cents higher than from Kansas City to St. Louis and that if that grain were reshipped from St. Louis to the east or to Atlantic ports for export, refund would have to be made of the difference between the Omaha rate and the Kansas City rate. It is difficult to see how under such an arrangement carriers could prevent such refund on grain actually shipped from Kansas City or what would prevent such concession unless the identity of the grain coming from Omaha were preserved. The only alternative would seem to be to require the grain coming from Omaha to St. Louis for the east to move through St. Louis without unloading. Such a requirement would certainly and naturally bring complaint of discrimination from the St. Louis people. It does not seem that a transit arrangement or proportional rate could be applied from St. Louis either to the east or to the southeast as proportional rates are applied from Kansas City, because here the purpose sought is to maintain a difference between the rates on grain coming from Omaha and Kansas City, respectively, when destined to a particular territory.[1] . . .

It is shown that in an intermediate belt running in an easterly and westerly direction, somewhat irregular in shape, taking in part of the northern portion of Kansas and a substantially equal part of the southern portion of Nebraska, the inbound rates to Kansas City and to Omaha are equal. The distance from the producing points in this equal zone is materially less to Omaha than to Kansas City. South of this zone a differential against

[1] On transit, see Vanderblue and Burgess, pp. 135, 215, 289.—Ed.

Omaha makes it impossible to ship to that market. North of that zone Kansas City's rates gradually increase and generally the rates favor Omaha. It appears that if the prayer of complainant were granted, Kansas City would be able to buy grain for the southeast and Mississippi Valley points upon an equality with Omaha at stations within 30 miles of Omaha.

One important carrier, the Illinois Central, has its own lines from Omaha to Memphis through one of the upper Mississippi River crossings. It does not reach Kansas City. It does not reach St. Louis from the west except through said upper Mississippi River crossing and a roundabout way. Is it to be expected that that company would permit rates from Kansas City to Memphis materially lower than from Omaha to Memphis?

At the time the present relative adjustment was established, Omaha 1 cent more than Kansas City on grain to Mississippi Valley and the southeast, an adjustment was also made to Minneapolis, Kansas City 1 cent above Omaha. It so happens that most of the grain that would move from Kansas City to Minneapolis would be wheat for milling and that most of the grain that would move from Kansas City or Omaha to the southeast would be corn.

As indicative of the probable effect of granting the prayer of complainant in this case, it is noted that from Minneapolis, located 375 miles north of Omaha, the rate to Memphis is now 2 cents more than from Omaha. If the rate from Omaha to Memphis were increased 2½ cents and the rate from Minneapolis to Memphis were not changed, Minneapolis would be able to ship to Memphis at a lower rate than would Omaha.[1]

The record shows that the Missouri Pacific and the Frisco System undertook to create a more favorable adjustment from Kansas City to the southeast, and the latter published a tariff providing that on grain from points in southern Nebraska, via Kansas City to Memphis and beyond, it would accept for the haul from Kansas City to Memphis the balance of the published through rate with a minimum charge of 9 cents per 100 pounds, and in numerous instances the tariff carried specific proportions of less than 9 cents. It was stated that this tariff had probably not attracted to those lines more than two or three hundred cars of

[1] For a later case involving the Memphis adjustment, see *Board of Trade of Kansas City* v. *St. Louis and San Francisco Railroad Company*, 32 I. C. C. 297, and especially the map at p. 308.—Ed.

grain, and witness for the Kansas City interests testified that it had not been of any value to that market.

In an adjustment of this kind, as the Commission has frequently said, we must scrutinize carefully not only the entire rate involved and the interests of the places and persons specially represented in the pleadings, but the certain and logical and probable effect of making a change. . . . In the present case we have the competition of primary markets, both of which are interested in the question solely from the standpoint of the profits to be gained from gathering in and redistributing to consuming territories and export ports the surplus grain in the territory lying west of them, and in which both should have, and apparently do now have, substantially equal opportunities. . . .

The Kansas City grain interests file complaint herein. The Omaha grain interests, the carriers serving Kansas City or Omaha, the St. Louis grain interests, the Wichita grain interests, the farmers and shippers of Kansas and the millers of Kansas are parties to this case and all protest against complainant's demands. The interests of numerous carriers not directly parties to the suit are necessarily involved. It is manifest that the prayer of complainant can not be granted without serious disturbances in rates, and there is no reasonable assurance that after such disturbances a more equitable or satisfactory adjustment would be reached. It is not seen how any substantial relief could be accorded to Kansas City in this matter without the creation of much discrimination and great confusion in transportation and commercial circles, and we are therefore forced to the conclusion that the complaint must be dismissed.

3. The Competition of Ports [1]

A special railroad import or export rate is in general due to one of two causes, a desire to build up the foreign trade of the United States or the necessity of equalizing rates through different rival ports so that all ports and available inland routes may share in the available foreign trade. These purposes are fundamentally different. Import or export rates made primarily to promote the foreign trade constitute a deliberate discrimination in favor of foreign trade as such. Should import and export rates of this

[1] This discussion is taken from *Preferential Transportation Rates*, a publication of the United States Tariff Commission which treats of the import and export rate structures in detail. See Jones, pp. 152–155, and Vanderblue and Burgess, pp. 133–135.

type be generally established in the United States they would exert a widespread influence upon the country's commercial policy. Such rates would be justifiable or not, according to whether the accepted policy of the United States is to encourage or discourage the import and export trade; and, if the former, whether or not railroad rates shall be utilized as a trade-promoting method to the extent of discriminating against domestic traffic.

Import and export rates designed primarily to equalize rival ports and inland routes would not constitute a distinctive part of a foreign trade policy of the United States. On putting them into effect the carriers but apply a principle which permeates all of the great domestic rate structures, and which has been generally approved by the Interstate Commerce Commission and the United States Railroad Administration alike for domestic and import or export rates.

The rate-making principle referred to is that railroad freight tariffs shall be so adjusted as to enable competitive producing districts, shipping points, markets, or transportation routes to do business without unreasonable freight rate handicaps.

The fixing of established relationships between rival ports by means of export or import railroad rates does not differ in principle from the establishment of relationships between such ports by means of domestic freight rates in so far as they compete as domestic markets or as points of domestic distribution. The application of the same principle in both the domestic and foreign trade, however, results in different port relationships, because the factors and forces influencing the ports are not identical in the domestic and foreign trade:

(*a*) The rivalry of the ports is usually more intense and wider in scope in the export or import trade than in domestic commerce. The exports or imports of the Central West, for example, may, if transportation charges and facilities permit, flow through any one of the larger North Atlantic ports in quantities limited only by the volume of foreign trade conducted by the Central West. Each one of these ports desires all the foreign trade it can get. It means employment and profit for its entire foreign trade organization, including the steamship lines and railroads serving the port; its trucking and lighterage companies; its banks, marine insurance companies and insurance brokers; its freight forwarders, freight brokers and ship brokers; its stevedores, towage companies, pilots, dry docks, ship supply merchants, and bunker coal concerns; its

customs brokers and customhouse organization; its export and import commission houses, merchants, and brokers. The volume of domestic trade handled between the Central West and the same ports, on the contrary and quite aside from transportation charges and available facilities, is influenced to a large extent by the amount of production and consumption within the limited domestic district served by each port.

New York and Boston, for example, are rivals for the domestic eastbound trade in that both require large quantities of central western products for consumption in New York and Boston, respectively, or for redistribution to other domestic markets, some of which are supplied from either of these ports. The carriers, with the approval of the Interstate Commerce Commission, have fixed the domestic rates from the Central West to Boston at established differentials above the domestic rates to New York because the greater distance to Boston warrants somewhat higher rates and the rivalry between the two ports, as domestic markets and distributing points for central western products, has not made it necessary to wholly equalize their eastbound rates. In the export trade, however, the rivalry of New York and Boston is not governed by limited markets in and relatively near each port, but by a desire to handle a maximum share of the entire export trade of the Central West. In order to enable Boston to compete with New York in this export trade the railroads have equalized the eastbound rates to Boston and New York on export traffic. It was necessary to abandon the usual domestic eastbound differentials of Boston above New York in the export trade unless the ocean carriers serving Boston were willing to adjust their outbound freights below those applicable at New York to such an extent as to place Boston on a competitive basis. It is clear that the reason why the rates to Boston on export traffic are lower than those on domestic traffic is not primarily to promote the export trade of the Central West, but to equalize Boston with New York, so that both ports, and the inland carriers serving each, may share in the handling of this trade.

The eastbound rates of New York and Boston are cited merely as examples of the varying influence exerted upon domestic and export or import rates by the greater rivalry obtaining between ports in the foreign as compared with the domestic trade. Both of these ports must compete against the other North Atlantic ports from Norfolk and Newport News to Montreal for the foreign

trade of the Central West. They must compete against the South Atlantic ports from Wilmington, N. C., to Jacksonville; against the Gulf ports from Key West to Galveston; and against the Pacific coast ports from San Diego to Prince Rupert. In so far as their rivalry is greater in the foreign than in the domestic trade, export and import railroad rates have been applied at many of these ports to bring about a degree of equalization quite

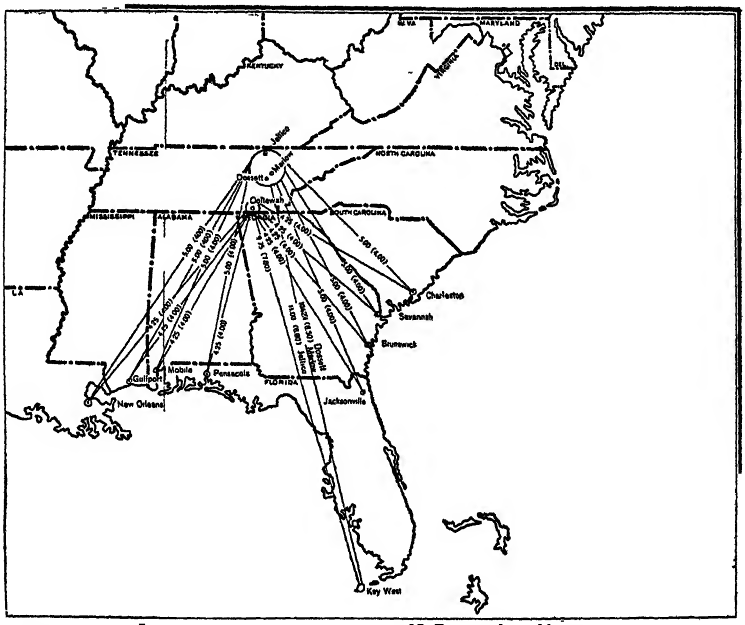


PLATE 9.—Rates on Imported Nitrate of Soda to Interior Southern Points, from South Atlantic and Gulf Ports. In Dollars per Ton of 2000 Pounds. Former rates in parentheses; present rates without parentheses.

unnecessary in the domestic trade flowing between the ports of the United States or Canada and the Central West.

The rivalry between the South Atlantic and Gulf ports for the import and export trade of interior southern points is similarly responsible for the great majority of the import and export rates applicable at these ports in the case of their southern traffic. Import and export rates are used to equalize the ports in whole or in part, so all may share in the foreign trade of the interior. [Plate 9.]

(*b*) The competition of the inland carriers serving the ports is closely connected with the rivalry of the ports as such. The four

general groups of rival ports—North Atlantic, South Atlantic, Gulf, and Pacific—are for the most part served by different railroads or other inland carriers, all of which desire to share in the foreign trade of the interior. At many central western points this foreign trade flows through any one of a wide range of ports provided the inland carriers serving the ports adjust their rates in such a way that the through charges between interior points in the United States and foreign destinations or sources of supply do not raise traffic barriers against particular ports. The lines serving the South Atlantic, Gulf and Pacific ports are quite willing to grant import and export rates to and from the Central West because they wish to share in this foreign trade traffic with the North Atlantic ports. Port and route equalization is their dominant motive. They do not discriminate against domestic trade as such; they discriminate in favor of import and export freight at particular ports so that all of it will not move via the inland carriers serving the North Atlantic seaboard.

The railroads connecting the South Atlantic ports with the interior southern points are similarly for the most part different lines than those serving the Gulf ports. The prime motive behind most of their import and export rates is to attract to their particular lines such import and export traffic as may move through South Atlantic or Gulf ports, provided their rates are not too far apart. They have, consequently, equalized many of their rates on import and export commodities to a degree not necessary in order to share in the purely domestic traffic.

Several of the eastern trunk lines serve more than one North Atlantic port, but most of them are rather definitely allied to particular ports. Port rivalry and the competition of the inland carriers serving the North Atlantic ports work hand in hand in the establishment of rate relationships which aim to enable each port and the inland carriers serving it to compete for the import and export freight traffic of the interior. [Plate 10.] New York, Philadelphia, Baltimore, Norfolk, and Newport News are so located with respect to the Central West and have a domestic rate structure so adjusted that they have in the past usually been able to compete with each other and with the ports located to the north and south without resorting to more than a limited number of import and export rates. . . . Export traffic shipped to Boston, however, moves on export rates because the domestic rates to Boston from the Central West are higher than those to New York,

and each of the ports farther north—Portland, Halifax, St. John, West St. John, Quebec, and Montreal—have been granted export and import rates that bear a fixed relationship to the prevailing rates applicable at New York, Philadelphia, or Baltimore. Should the existing differentials in favor of rival ports, particularly the

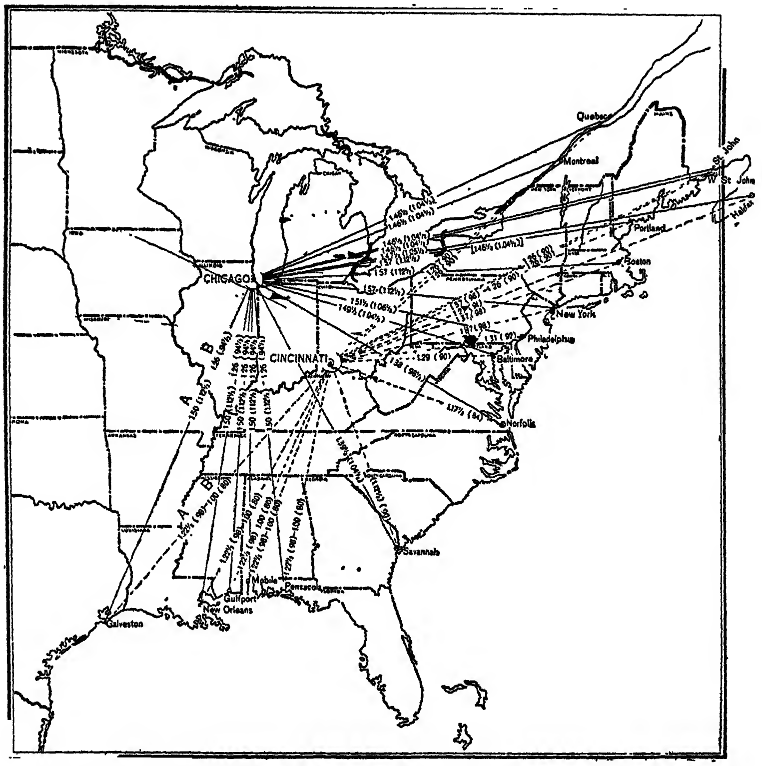


PLATE 10.—Rates on First Class Import Traffic from Atlantic and Gulf Ports to Chicago and Cincinnati. In Dollars per 100 Pounds. Former rates in parentheses; present rates without parentheses. Rates from the Gulf ports under A are on traffic from Asia, Australia, New Zealand, Philippine Islands, Central and South America. Rates from the Gulf ports under B are on traffic from Africa and Europe. Rates in brackets from Portland, Me. are via the Grand Trunk.

heavy differentials now granted to Gulf ports, greatly reduce the relative volume of export and import traffic usually handled at the North Atlantic ports, prompt action may be expected on the part of the latter and the lines serving them to narrow such differentials either by bringing about an increase in the export and

import rates applicable at rival ports or by granting more import and export rates to New York, Philadelphia, and Baltimore.

(c) A third reason why different port relationships result, although the same principle of equalization governs both domestic and import or export traffic, is that ocean freight rates are always an important factor in the overseas trade. Port equalization in the foreign trade, as far as charges are concerned, is not attained unless the through freight charges between foreign ports and points in the interior of the United States are equalized at the various American ports. Complete port equalization depends not only on the inland freight rates to or from the rival ports of the United States and Canada, but also on the ocean freights to or from these ports, and to a less extent on cargo charges such as cartage, lighterage, and wharfage, in so far as they may not be included in inland or ocean freight rates, and on marine insurance charges payable by exporters and importers. Indeed, port equalization in the foreign trade is not always accomplished by equalizing through-freight charges, for differences in ocean transportation services may handicap one port in its competition with another.

It is mainly because inland and ocean freight rates are for the most part made by different carriers that complete equalization of through-freight charges is not obtained. A few of the ocean steamship lines are operated by railroad companies, but the great majority of them are operated by separate steamship companies or steamship agents. Their rates fluctuate and they do not regularly meet the railroads in conference. Both the steamship lines and the railroads are interested in moving imports and exports through the particular ports served by them; both are concerned with the through charges between foreign ports and the interior American points and in the establishment of port relationships; but each is willing that the other should do whatever equalization is necessary. The result is that ocean rates at different ports are adjusted in a general way with reference to existing railroad rates and vice versa; a substantial degree of equalization is obtained, but it is by no means complete and is not always strictly maintained.

Theoretically "any difference which exists from the viewpoint of ocean mileage as a disability should be taken care of entirely as between the ocean lines," but in practice the ocean lines may fail to take care of such disability in full, and the railroads serving partic-

ular ports may find it necessary to take this into consideration in fixing their import or export rates. When the Gulf import differentials on traffic originating in Europe, Africa, and Asia, for example, were established in 1907 the eastern railroads contended that equalization would be attained by placing Gulf ports on the Baltimore basis, the class rates from Baltimore being 8, 8, 3, 3, 3, and 3 cents per 100 pounds lower than those applicable from New York. The Gulf rail lines, however, contended for differentials of 17, 14, 12, 8, 7, and 6 cents below the Baltimore rates on classified import traffic, largely because of higher inbound ocean rates at the Gulf ports; and the arbitrators selected to decide the issue decided upon class rate differentials of 18, 18, 12, 8, 6, and 6 cents below the New York rate basis. There is no evidence that in establishing these differentials, which governed the import rates applicable from Gulf ports to Chicago in case of traffic originating in Europe and Africa until they were disrupted by the general railroad rate advance effective August 26, 1920, the arbitrators of 1907 were in any way moved by a desire to promote the import trade of the United States as such or to discriminate against domestic commerce. They were concerned entirely with establishing such a relationship between Gulf and North Atlantic ports as would enable the former to share in the existing import trade of the Central West.

Various general methods or plans are applied in establishing import and export rates with a view to equalizing competitive ports.

(1) The most general method applied by the United States Railroad Administration when it authorized the reestablishment of import and export rates was to apply the existing domestic rates to and from a so-called pivotal or key port, but to preserve the relationship existing between the various competitive ports on June 24, 1918, i. e., retain the relationship existing before the director general had ordered the cancellation of import and export rates. Wherever this plan was applied it follows that no import or export rates apply at the pivotal or key port in case of a given commodity and that the domestic rates of this port are applied at the other ports as import or export rates, or are the basis for such rates at the other ports. Each of the ports, however, retains its own domestic rates, which are higher than the import rates except at the key port where the domestic and import or export rates are identical. The port having the lowest domestic rate is usually

selected as the key or pivotal port in the application of this general plan. When rates were established in accordance with this rule by the Railroad Administration for Federal lines they were also approved by the Interstate Commerce Commission for lines which were not under Federal control.

The application of this rule is most common in case of import or export rates applicable at ports all of which are within the same general traffic district. The export rates on fertilizer material from the inland cities of Atlanta, Macon, and Birmingham to the Gulf ports, for example, are the domestic rates to Mobile, serving as the pivotal port. The import rate on asphalt from Gulf ports to interior points of the South are likewise, with certain exceptions, made by using the Mobile domestic rates as the basis. Imported pyrites move from the Gulf ports to southern points such as Chattanooga and Atlanta on import rates determined by applying the domestic rates from Mobile with June 24 relationships continued from other ports. The export rates on wheat and grain products and flour from central western points to the North Atlantic ports are based upon the domestic rates to Baltimore, at which port the export and domestic rates are identical.[1]

Many additional examples of the quite general application of this method of establishing import and export rates will be cited in subsequent chapters in which existing rate adjustments are analyzed. The domestic rate at a key port is either applied as the import rate at a whole group of competitive ports or it is taken as the basis or starting point, and the import rates from other ports are established with reference to it by adding differentials. The fact that no import or export rate applies at the key port or that it is the same as the domestic rate is again indicative of the fundamental desire to equalize the ports rather than to discriminate against domestic commerce.

(2) A second method which has been adopted in establishing import and export rates for the purpose of equalizing ports is the application of fixed differentials to the rates applicable to import or export traffic at some selected key or pivotal port or the general

[1] The export, import, and domestic railroad rates specifically referred to or charted in the commission's report were checked during the year 1920. Some of these rates have probably been changed between this date and the date of the printing of the report, as it is known that many freight rates have been readjusted since the general rate advance of August 26, 1920, and a few additional import and export rates have probably been established since 1920. It is, however, not believed that such readjustments in any way change the principles and conclusions reached in the report.

adoption of the actual key port rate without adding or deducting a differential. This method differs from the first-mentioned plan in that the key or pivotal port is not necessarily the port having the lowest domestic rate, and also in that the key or pivotal port is not limited to domestic rates.

The import rates from the Gulf to many central western points on traffic originating in Europe or Africa are, as was stated above, established at fixed differentials below the westbound rates from New York; and those on traffic originating in Asia, Australia, New Zealand, and the Philippine Islands, and on some traffic originating in Central and South America, were generally the same as the New York rates until this relationship was disturbed by the general rate advance of August 26, 1920. The long-established relationship between the Gulf and North Atlantic ports on traffic originating in countries other than Europe, Africa, Asia, Australia, New Zealand and the Philippines was to fix the import rates of the former with relation to the rates from Baltimore. It was but recently that some of the traffic originating in Central and South America was included in the Gulf import tariffs governing traffic originating in Asia, Australia, New Zealand, and the Philippines. The export rates to the North Atlantic ports, including Boston and points north, also illustrates this method of equalizing ports. The export rates from Chicago to Boston are the same as the prevailing domestic or export rates to New York; so also were those via the Grand Trunk to Portland, Me., and those to Quebec, St. John, and West St. John until the recent disturbance of established rate structures. The export rate from Chicago to Montreal, with few exceptions, is based upon the domestic or export rates to Philadelphia, and export rates from Chicago to Halifax have generally been made by adding 1 cent per 100 pounds to the New York domestic or export rates. At present only a few export rates apply at New York and Philadelphia, but more export rates have applied at these ports in the past, and their present export rate on grain, grain products, and flour indicate that the key ports governing the export rates effective at Boston, Portland and eastern Canadian ports are not limited to domestic rates. In some instances the export rates to New York or Philadelphia are the basis, while in others their domestic rates govern.

(3) Some of the import or export rates which are designed to equalize ports are not established in accordance with any definite plans such as those defined above, but are merely reduced suffi-

ciently to enable certain ports and inland carriers to compete more effectively with their rivals. The import and export commodity rates applicable at the Pacific ports are not made by generally applying the domestic rates of some pivotal Pacific port; indeed such procedure would be ineffectual because the transcontinental domestic rates to and from the various Pacific ports differ but slightly, and the lowest domestic rate in case of any given commodity would, if applied to import or export traffic at all the Pacific ports, be of little assistance to these ports in their competition with the ports of the Atlantic and Gulf seaboards. Nor are their import and export rates based upon the domestic or import and export rates applicable at any of the Atlantic and Gulf ports by the application of any definite system of differentials. The import and export rates between the Pacific ports and points in the Central West, East, and South are special rates applicable to selected lists of commodities originating in or destined to various foreign countries of the Pacific Ocean. They bear no specific relationship to the rates applicable at rival Atlantic and Gulf ports, yet the files of the Railroad Administration indicate that the dominant reason why they were reestablished after having been canceled in 1918 was to enable the Pacific ports and the transcontinental railroads serving them to more effectively compete against their eastern and southern rivals. . . .

As the great majority of the import and export rates now in effect in the United States are designed to equalize ports or to establish workable port relationships, whatever problems are connected with them are greatly simplified. So long as it is deemed desirable that all ports and the inland routes serving them should be permitted to share in the import and export trade of interior points, it naturally becomes necessary to apply import and export freight rates at some of the ports. Few may be needed at the pivotal or key port in a given competitive district, but the revenue needs of the railroads serving the others do not permit them to handle their entire traffic, domestic as well as foreign, at the relatively low rates which competition with rival ports and inland routes imposes upon their import and export traffic. Even the pivotal ports may require export and import rates for purposes of port equalization should those to and from rival ports result in unreasonable handicaps which are not removed by adjusting all rates with reference to the domestic rates of the former.

Import and export rates designed primarily to promote the

foreign trade of the United States by discrimination against domestic commerce are the exception rather than the general rule. The present situation is well summarized in the 1919 annual report of the Director General of Railroads as follows: "The restoration of more nearly normal commercial conditions, the larger number of American ships available for foreign trade, and the continued congestion at many ports soon demonstrated the necessity of equalizing the rate bases to and from certain territories and ports so as to distribute the movement of the traffic for the advantage of all interests. Among the changes or revisions made are: The revision of both import and export rates via Pacific coast ports more nearly to equalize the shipping routes via the Atlantic and Gulf ports and the publication of revised export rates from points in central territory to the South Atlantic and Gulf ports better to distribute export traffic."

It is significant that the United States Government itself re-established import and export rates while the railroads were under Federal control and that its principal purpose was port equalization.

CHAPTER X

THE DISTANCE PRINCIPLE: A COMMODITY DISTANCE SCALE

1. Western Cement Rates: Original Opinion [1]

Daniels, *Commissioner:*

In 1880 the recorded production of cement in the United States was 42,000 barrels. In 1890 it was 335,000 barrels. During this time, and perhaps down to 1895, the bulk of the cement consumed in the United States was imported from foreign countries. In 1900 the domestic production rose to 8,482,020 barrels, or 200 times the production in 1880. In more recent years the figures are as follows, expressed in barrels:

1907	48,785,390
1912	82,438,096
1913	92,097,131
1914	88,230,170
1915	85,914,907

The falling off of the production in recent years should not be overlooked.

Prior to 1900 the production in the United States was practically all east of the Indiana-Illinois state line. In 1890 a mill was built at Yankton, S. Dak., which was operated more or less continuously for 18 or 20 years, but is not now in existence. Another portland cement mill was constructed during the nineties at White Cliffs, Ark., but it was not successful. The oldest mill west of the Mississippi which the record shows as now in operation is the mill at Iola, Kans., which was constructed in 1900. The first successful mill on the Mississippi River was the one at Prospect Hill, near St. Louis. This was constructed in 1902.[2] . . .

[1] *Western Cement Rates*, 48 I. C. C. 201 (January 15, 1918). See Vanderblue and Burgess, pp. 139–156; and, for a typical distance scale of class rates, *C. F. A. Class Scale Case*, 45 I. C. C. 254.—Ed.

[2] The dates of construction of certain of the cement mills and their location appear in the table on the following page. The table may suggest that at least one cause of the curtailment of the markets of certain producers is the construction of new mills nearer to those markets.

OBJECTIONS TO VARIOUS ADJUSTMENTS

The controversy as to cement rates is primarily between producers rather than between producers and carriers. Many projects of adjustment have been submitted, all of them, with the exception of the western adjustment proposed by the Burlington, being submitted by the cement companies themselves. There have been offered group adjustments, distance adjustments, and combinations of the two. The proposals of each producer have been objected to by its rival as being founded upon self-interest. The general attitude of the carriers is fundamentally that of protecting existing revenues, and with this attitude most of the producers seem to be in harmony. It is insisted, however, that certain rate irregularities, such as those alleged to exist against the La Salle mills in southern Wisconsin and at Milwaukee, against the gas belt mills in western trunk line territory, and particularly east of the Missouri River, and against the Michigan mills in Wisconsin and the northern peninsula of Michigan, should be removed. Of the group plans offered, we agree with their critics that they are too highly colored by self-interest for them to be accepted in their entirety. For instance, the following is proposed by the gas belt mills, the distances used being taken from their exhibits:

Footnote 2 continued from page 212.

Location and date of construction of cement mills

1896	Chicago, Ill	Universal Portland Cement Co. (Illinois Steel Co.)
1897	La Salle, Ill	Marquette Portland Cement Co.
1900	South Chicago, Ill	Universal Portland Cement Co. (Illinois Steel Co.)
1900	Iola, Kans	Iola Portland Cement Co.
1901	Portland, Colo	Colorado Portland Cement Co.
1901	Hannibal, Mo	Atlas Portland Cement Co.
1902 (before)	Coldwater, Mich	Wolverine Portland Cement Co.
1902	Prospect Hill (St. Louis, Mo.)	Union Sand & Material Co.
1903	Buffington, Ind	Universal Portland Cement Co.
1903	Oglesby, Ill	Chicago Portland Cement Co.
1907	Sugar Creek, Mo. (Kansas City, Mo.)	Union Sand & Material Co.
1908	Chanute, Kans	Ash Grove Lime & Portland Cement Co.
1908	Ada, Okla	Oklahoma Portland Cement Co
1909	Mason City, Iowa	Northwestern States Portland Cement Co.
1910	Des Moines, Iowa	Hawkeye Portland Cement Co.
1911	Mason City, Iowa	Lehigh Portland Cement Co.
1916	Steelton (Duluth, Minn.)	Universal Portland Cement Co.

	Miles	*Proposed rate*
Iola group to Kansas City	134	5
Mason City to St. Paul	144	6.5
Des Moines to Omaha	145	7
Buffington to Milwaukee	[1] 165	7

Contrasting the conditions surrounding traffic from southeastern Kansas with those prevailing within the other districts included in the above comparison, we must conclude that there is no basis afforded by the gas belt group and zone plan for an equitable adjustment of rates. . . .

THE PRINCIPLE OF A DISTANCE SCALE

The two factors in the construction of a distance scale are the terminal charge and the road-haul charge. A witness for the Nebraska commission testified as to terminal costs, estimating the expense of originating a carload shipment at a switching service station and terminating it at a nonswitching service station to be 1.0059 cents per 100 pounds, but this figure does not include all of the operating expenses and neither interest nor taxes, and the witness could not estimate what amount should be allowed for these omissions. The terminal charge at best is speculative, and no method has yet been found of exactly computing it. To determine the rate for a given distance, there is added to the assumed terminal charge a certain amount to represent the road haul. Upon the rate of increase in the road-haul charge for successive distances depends the level of the rates. If it be maintained that the policy of carriers should be to afford the widest possible latitude to competition, which is consistent with any return short of actual loss, the proponents of a distance scale will favor a low rate of increase for unit progressions, and this will result in relatively low rates for long distances. Thus, a distance scale directly reflects the purpose of its maker. No one contends that a carrier should be compelled to haul a commodity for less than cost, but an acceptable demonstration of what is the actual cost to a carrier of transporting a given commodity has yet to be determined, and the cost will vary upon different lines. Therefore, as a general rule, the reasonableness of rates is still determined according to the usual well-known methods, important among which are rate

[1] Distance calculated via route rate applies.

comparisons, distance, and considerations of traffic density and population.

The Kansas gas belt mills frankly admit that they desire a set of rates which will enable them to place their cement in far distant markets, and their [proposed] distance scale reflects this purpose. It lowers many existing rates to important markets and while it is claimed that the readjustment of traffic would result in no decrease in the carriers' revenues this claim is vigorously disputed. . . .

Those who propose a system of rates, the avowed purpose of which is to promote long-distance competition, confuse an economic problem with a transportation problem. Primarily it is not our concern to equalize market competition. A shipper who comes to us with a proposition of this character urging that the difference in freight rate against him is what keeps him out of an important market near which a competitor is situated implies to a greater or less extent that the difference in freight rates represents the amount of his handicap. But freight is only one of the factors in a shipper's selling price. Among the cost factors figured by a shipper in laying down his product at a certain destination, fundamental and most important are his costs of production, including his costs of raw material and labor, and all of the elements which combined make up the cost of the finished product at his plant. These are secrets, perhaps the most closely guarded in the shipper's business. We can not overlook the fact that though a cement mill is located at a distance from important markets the location has presumably been selected advisedly and that due consideration has been given to the question whether its remoteness from these markets is balanced by compensating economies not available nearer the destinations. The enormous movement over the Burlington from Hannibal to St. Paul, in spite of the rate handicap of 4 cents over Mason City; the very heavy tonnage from Hannibal to Chicago, with the Buffington and La Salle rate handicaps to overcome; to say nothing of the large movement from La Salle to St. Paul, where a similar handicap of 4 cents over Mason City must be overcome, demonstrates the fallacy of laying too much stress upon the factor of freight rate alone in the problem of marketing cement. We must not be understood, however, as opposed to any plan which will result in the making of reasonable rates for long distances. What we do consider as unwarranted is the formulation of a scale for the express purpose of affording long-distance competition at rates which are unreasonably low. . . .

The normal tendency of cement traffic is toward a comparatively short haul. Witness an exhibit of the Burlington showing the preponderance of traffic upon hauls of 175 miles and under; the showing of the Lehigh Portland Cement Company that out of a total of 3,700,000 barrels shipped in 1915 from Mason City, only 276,000 went to the Dakotas, Nebraska, Kansas, and Missouri combined, practically 3,000,000, about equally divided, going to destinations in Iowa and Minnesota, of which latter 525,000 were delivered to the twin cities; the further showing of the Lehigh Company that they would not regard it as good business policy to exploit the Nebraska market to any extent, although it elsewhere appears in the record that to many Nebraska destinations, on the Burlington at least, the haul is shorter from Mason City than from the gas belt. To this may be added the testimony of the witness from a Michigan mill who explains that his mill would not attempt to ship into the Chicago market because, to use his own words, "our policy of sale would take into consideration the fact that if we should ship our product 230 miles into Chicago when there was a large producer adjacent to Chicago, the only effect of that would be to force that much cement out of the Chicago district into other districts, possibly ours, which would be a detriment both to our plant and the plants operating around Chicago, and the only ones to reap the benefit would be the railroads."

The scale which we shall adopt will be applied via the short-line workable route. Objections based upon the use of the shortest possible route as the proper basis for calculating distance will, therefore, disappear. The difference between the short-line workable and the actual route averages 7.3 per cent according to the exhibits of 16 carriers on September, 1915, traffic. . . .

BASIS OF FINAL ADJUSTMENT

We are convinced upon the record that a strict distance adjustment is too rigid for universal application within this territory, and there seems to be a quite general concurrence in this view. . . .

The two interests between which is the greatest conflict are the Kansas gas belt group of mills and the Universal Portland Cement Company. Each of these interests submitted group plans, and the key points selected by them were many of them common to each plan. We shall take all of the principal key points in each of their plans and add thereto Madison and Wausau, Wis., and

Escanaba, Mich., and determine the reasonable maximum rates to these various key points from the principal points of production in western trunk line territory. . . . It developed at the oral argument upon the report herein as originally proposed that an intermediate application of the key point rates as maxima would often cause substantial reductions from the scale rates and make it impossible for the carriers to obtain such a rate for a haul intermediate to a key point via an indirect route as it would be entitled to from the application of the scales herein found reasonable. In

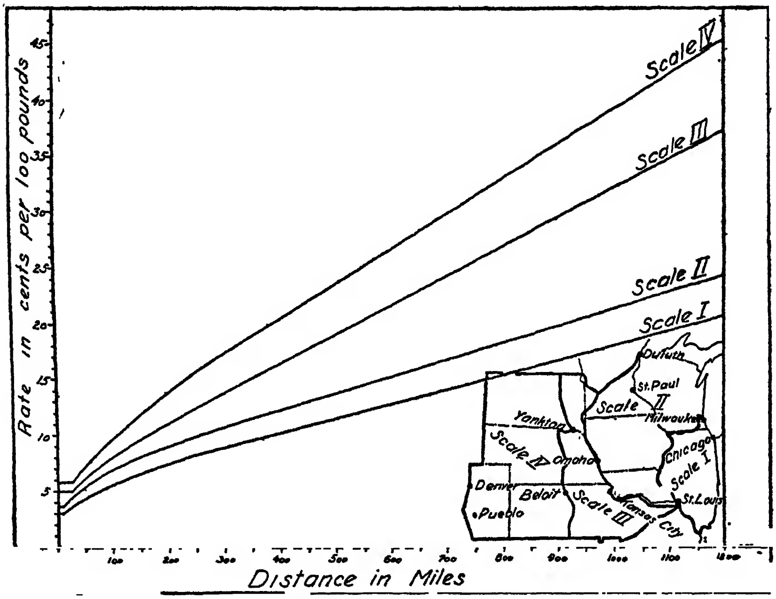


PLATE 11.—Cement Scales Prescribed in *Western Cement Rates.*

order to make adequate provision for these situations permission will be granted to depart from the long-and-short-haul rule of the fourth section at points intermediate to key points, provided that the scale rates herein prescribed are not exceeded at such intermediate points, and that such rates are not in excess of the lowest combination. . . . The territory to which each scale is applicable is shown upon . . . [Plate 11].

The rates from the Kansas gas belt to points east of the Missouri River within scale II territory shall be upon the level of scale II. While the record shows that the density of traffic in southeastern Kansas is fairly comparable with the density of

traffic between the rivers, it is not for this reason primarily that we consider that scale II rates should be applicable upon cement traffic from those mills to those destinations. It will be recalled that the most important movement of cement from the Kansas gas belt mills is to Kansas City. The average of the short-line distances to Kansas City from those mills is 134 miles. The rate allowed under scale II for 134 miles is 7.7 cents. . . .

The single-line movement from Newaygo to Milwaukee is northerly to Ludington, thence to destination via the Pere Marquette car ferry. Such a route is altogether in scale II territory. The contention is made that a route 20 miles shorter exists involving a southerly movement from Newaygo via the Pere Marquette to Grand Haven, Mich., thence via the Grand Trunk car ferry to Milwaukee. Via this route only 40 miles out of a total of 145 miles is stated to be in scale II territory. Newaygo being local to the Pere Marquette, the latter route would compel that carrier to short haul itself. The short workable route must be considered in this instance the single-line route. Having determined the basis for rates from Newaygo and Alpena to other Wisconsin points, we find that the reasonable basis to Milwaukee from the same producing points is the scale II basis. . . .

Following is a table of rates to the principal key points from producing mills in western trunk line territory which we find to be reasonable maximum rates to be observed for the future.

While all factors have been taken into account in the determination of these rates, we have considered distance of primary importance, but due consideration has been given to density of traffic and other factors. . . .

RATE ADJUSTMENT WEST OF SCALE II OF TERRITORY

The evidence shows that it is impossible to find one scale or level of rates that will apply to all of the territory involved in this proceeding west and northwest of the Missouri River. . . . We accept the suggestion of the Burlington witness that the territory west of the Missouri River should have two scales. However, after a study of the average earnings and selected rates given in exhibits of record, and giving due weight to the factors of traffic density and population in that portion of the territory nearer to the Missouri River, we believe that a scale which is lower than the Burlington 140 per cent scale should be used. In lieu of this last-mentioned scale there should be substituted scale III. . . .

KEY POINT RATES

			Proposed					Proposed		
	Miles	Present	Iola group and zone	Universal group	Rate found reasonable	Miles	Present	Iola group and zone	Universal group	Rate found reasonable
	To Chicago					To Milwaukee				
Buffington......	22	[1] 2.5	3.5	....	....	[2] 85	6	7	6	6
La Salle.........	96	4.5	4 5	6.3	5.6	169	7	7	7	6.4
Mason City......	326	10	9.5	10	10	299	10	9	10	9.8
Hannibal.........	282	6.5	8	8.9	8.8	360	10	9.5	10	9.7
St. Louis.........	282	7	8.5	8.9	8 8	354	11	10	11	9.7
Duluth...........	465	12	11	13	12.2	376	10	10	13	12
Des Moines......	344	12	9.5	12	10.5	373	12	10	12	11
Kansas City.....	439	12.5	10.5	13	12	513	12.5	11	13.5	13
Iola District.....	572	15	12	15.5	13 8	647	20	12.5	16	14.9
	To St. Paul					To St. Louis				
Buffington......	396	10	11	11	10.7	282	7	8.5	8.9	8.8
La Salle.........	377	10	10	11	10.4	228	6.5	8	7.9	8
Mason City......	140	6	6.5	6.5	7	419	12	10.5	12	12.6
Hannibal.........	422	10	11	11.5	11.1	117	4	4.5	6.3	6.1
St. Louis.........	540	10 5	12	12.5	12.5	....	....	2.5	....	....
Duluth...........	151	6	6.5	6.5	7.3	691	....	13.5	14.5	15.4
Des Moines......	258	8	8 5	8.5	8.9	334	10	9.5	11	11.4
Kansas City.....	482	14.5	11	13.5	12.3	277	10	8.5	9.5	10.4
Iola District.....	616	15	12.5	16	14	364	12.5	10	12	11.8
	To Kansas City					To Omaha				
Buffington......	439	12.5	11	12.5	12	476	12.5	11.5	12.5	12.4
La Salle.........	360	11	10.5	11	10.7	404	11	10.5	11	11.4
Mason City......	339	11	9.5	11	11.4	209	8	8	8	9
Hannibal.........	199	10	8	9	9	318	10	9.5	10	11
St. Louis.........	277	10	8.5	9	10.4	413	10	10.5	11	12.6
Duluth...........	627	....	12.5	15	15.9	497	13	12	13.5	13.8
Des Moines......	218	9.5	8	9.5	9.4	145	7	7	6.5	8
Kansas City.....	...	....	2.5	1.5	....	200	8.5	8	8	9
Iola District.....	134	5	5	6.5	7	328	10	9.5	11	11

[1] Rates to different points within the Chicago switching district vary according to different deliveries.

[2] This would be 107 miles, . . . if the short-line distance of 22 miles from Buffington to the Lake Shore passenger station in Chicago is added.

KEY POINT RATES—Continued

	Miles	Present	Proposed		Rate found reasonable	Miles	Present	Proposed		Rate found reasonable
			Iola group and zone	Universal group				Iola group and zone	Universal group	
	To Sioux City					To Sioux Falls				
Buffington	510	13	....	13.5	13	526	13.5	....	14	13.2
La Salle	439	13	....	13	11.8	475	13.5	....	13.5	12.4
Mason City	194	9.5	....	8.4	[1]9	199	10.5	....	10	9
Hannibal	409	13	....	12.5	12.4	452	13.5	....	13.5	13.2
St. Louis	508	13	....	13.5	14.1	569	14.5	....	14.5	15
Duluth	422	13	....	13	12.7	343	13	....	13	11.5
Des Moines	194	7.7	....	7.7	[1]9	235	10.5	....	10	9.7
Kansas City	286	13	....	10	10	377	15	....	12	12
Iola District	420	13	....	13	12	511	17.5	....	14.5	14
	To Madison, Wis.					To Wausau, Wis.				
Buffington	130	8.5	....	7.5	7	265	10	....	10	9.4
La Salle	136	8.5	....	7.5	7	289	10	....	10	9.7
Mason City	215	10	....	10	9.4	280	10	....	10	10
Hannibal	310	11	....	10.3	10	458	13	....	14	12.1
St. Louis	349	....	....	11.5	10.6	497	....	....	15	12.7
Duluth	325	....	....	12	11.2	225	....	....	9	9.5
Des Moines	300	....	....	12	10.7	399	....	....	12	11.3
Kansas City	459	....	....	13.5	13.2	617	....	....	17.5	15.6
Iola District	593	....	....	16	15	753	....	....	20	17.7
	To Escanaba, Mich.									
Buffington	315	11	....	11	10.5					
La Salle	368	11	....	11	10.8					
Mason City	448	13	....	14	13					
Hannibal	563	14	....	15	14					
St. Louis	590	....	....	16	14.5					
Duluth	301	....	....	10	10.9					
Des Moines	569	....	....	16	15					
Kansas City	712	....	....	19.5	17.1					
Iola District	846	....	....	22	19.3					

[1] The rates herein stated between Iowa points can rarely, if ever, have interstate application. The rates are, however, suggested as reasonable rates for the movements involved, and nondiscriminatory as compared with the interstate rates herein found reasonable.

Scale IV territory shall include that portion of Colorado lying east of a line drawn north and south through Trinidad, Canon City, Cripple Creek, and Denver; thence north to the Colorado-Wyoming state line; and also the balance of Kansas, Nebraska, and South Dakota lying west of the western boundary of scale III territory. Scale IV is the same as the Burlington 160 per cent scale, with certain modifications for distances less than 80 miles. . . .

The four scales which we find reasonable herein . . . are as follows: [table on page 222]. . . .

The scales found reasonable herein are graphically represented in . . . [Plate 11].

No distinction in rate is made for hauls over more than one line. Such does not seem to have been the practice of carriers in this territory with reference to cement.

Where a producing point is located upon the boundary line between territories, the proper scale or scales to apply depends upon the direction of the movement. In such cases the producing point shall be considered to be in that territory within which the point of destination is located, except that, if the point of destination is not in either of the territories whose common boundary passes through the producing point, then the producing point shall be considered to be within the territory which is bounded by such common boundary line lying nearest to the point of destination; and except further, that from Hannibal and St. Louis to scale II destinations in Minnesota, Iowa, and Wisconsin where there is an intermediate movement through Illinois, the rate shall be the average of scales I and II. A similar rule *mutatis mutandis* will be applied to destinations located upon boundary lines. For the purposes of this report Hannibal and St. Louis are upon the boundary between scale territories I and II, Sugar Creek and Bonner Springs upon the boundary between scale territories II and III, and Steelton upon the boundary of scale territory II. Sugar Creek and Bonner Springs should take the same basis of rates for line hauls in all directions.

We are further of the opinion and find that a uniform minimum weight of 50,000 pounds is reasonable throughout the territory within the scope of this investigation, and that if a lower minimum weight of 38,000 pounds is published the rates given herein should be increased by 13 per cent. Where the reasonable rate is not made with reference to the key point rates, as for instance to points

MILES	*Scale I*	*Scale II*	*Scale III*	*Scale IV*	MILES	*Scale I*	*Scale II*	*Scale III*	*Scale IV*
5 Miles					371–380	9.9	12	15.9	20.1
and under	3	3.6			381–390	10.1	12.2	16.1	20.4
6–10	3.2	3.8			391–400	10.2	12.3	16.4	20.8
11–15	3.4	4	[1]5	[1]5.9	401–410	10.3	12.4	16.7	21.1
16–20	3.5	4.3			411–420	10.5	12.6	16.9	21.4
21–25	3.7	4.5			421–430	10.6	12.7	17.2	21.7
26–30	3.9	4.6	5.3	6.4	431–440	10.7	12.9	17.4	22
31–35	4	4.8	5.6	6.6	441–450	10.9	13	17.7	22.4
36–40	4.2	5	5.8	6.9	451–460	11	13.2	18	22.7
41–45	4.3	5.1	6	7.1	461–470	11.1	13.3	18.2	23
46–50	4.5	5.3	6.2	7.3	471–480	11.2	13.5	18.5	23.2
51–55	4.6	5.5	6.4	7.6	481–490	11.4	13.6	18.7	23.5
56–60	4.7	5.7	6.6	7.8	491–500	11.5	13.8	19	23.8
61–65	4.8	5.8	6.8	8	501–520	11.8	14.1	19.5	24.4
66–70	5	6	7	8.3	521–540	12	14.4	20	25.1
71–75	5.1	6.1	7.2	8.5	541–560	12.3	14.7	20.6	25.7
76–80	5.2	6.2	7.3	8.8	561–580	12.5	15	21.1	26.2
81–85	5.3	6.4	7.6	9.1	581–600	12.8	15.3	21.6	26.8
86–90	5.4	6.5	7.7	9.2	601–620	13.1	15.6	22.1	27.5
91–95	5.5	6.7	7.9	9.6	621–640	13.3	15.9	22.6	28.1
96–100	5.6	6.8	8	9.9	641–660	13.6	16.2	23.2	28.8
101–110	5.9	7.1	8.3	10.4	661–680	13.8	16.5	23.7	29.2
111–120	6.1	7.3	8.7	10.8	681–700	14.1	16.8	24.2	29.9
121–130	6.3	7.5	9	11.3	701–720	14.4	17.1	24.7	30.5
131–140	6.5	7.7	9.3	11.8	721–740	14.6	17.4	25.2	31.2
141–150	6.6	8	9.7	12.1	741–760	14.9	17.7	25.8	31.8
151–160	6.8	8 2	10	12.6	761–780	15.1	18	26.3	32.3
161–170	7	8.4	10.2	13.1	781–800	15.4	18.3	26.8	32.9
171–180	7.2	8.6	10.6	13.4	801–820	15.7	18.6	27.3	33.6
181–190	7.3	8.8	10.8	13.9	821–840	15.9	18.9	27.8	34.2
191–200	7.5	9	11.1	14.2	841–860	16.2	19.3	28.4	34.8
201–210	7.6	9.2	11.3	14.7	861–880	16.4	19 6	28.9	35.3
211–220	7.8	9.4	11.6	15	881–900	16.7	19.9	29.4	36
221–230	8	9.5	11.9	15.3	901–920	17	20.2	29.9	36.6
231–240	8.1	9.7	12.2	15.8	921–940	17.2	20.5	30.4	37.2
241–250	8.2	9.9	12.5	16.1	941–960	17.5	20.8	31	37.9
251–260	8.4	10.1	12.8	16.4	961–980	17.7	21.1	31.5	38.4
261–270	8.5	10.2	13	16.8	981–1,000	18	21.4	32	39
271–280	8.7	10.4	13.3	17.1	1,001–1,020	18.3	21.7	32.5	39.6
281–290	8.8	10.5	13.5	17.4	1,021–1,040	18.5	22	33	40.3
291–300	8.9	10.7	13.8	17.7	1,041–1,060	18.8	22.3	33.6	40.9
301–310	9	10.9	14.1	18	1,061–1,080	19	22.6	34.1	41.4
311–320	9.2	11.	14.3	18.4	1,081–1,100	19.3	22.9	34.6	42
321–330	9.3	11.2	14.6	18.7	1,101–1,120	19.6	23.2	35.1	42.7
331–340	9.4	11.4	14.8	19	1,121–1,140	19.8	23.5	35.6	43.3
341–350	9.6	11.5	15.1	19.3	1,141–1,160	20.1	23.8	36.2	44
351–360	9.7	11.7	15.4	19.6	1,161–1,180	20.3	24.1	36.7	44.4
361–370	9.8	11.8	15.6	20	1,181–1,200	20.6	24.4	37.2	45.1

[1] Twenty-five miles and under.

in scale III and scale IV territories from points of origin, the rate shall be calculated on the basis of an average of the rates for the entire distance measured by the short-line workable route under the scales in effect in the different territories traversed by such route.

Carriers should establish through routes and joint rates via all reasonably available direct lines. If, in any case, they fail to establish such route and rate, any complaining party may call our attention to that particular instance by petition filed in appropriate proceedings. . . .

2. Supplemental Report of the Commission [1]

Daniels, *Chairman:*

In our previous report, 48 I. C. C., 201, we prescribed maximum rates for the interstate transportation of cement within western trunk line territory and between points in western trunk line territory and certain territories adjacent thereto. The general territory involved was divided into zones or scale territories numbered, respectively, I, II, III, and IV, the limits of which are defined in our report. For scale territory I, which embraces substantially all of the state of Illinois and a narrow strip of southern Wisconsin, we prescribed a basic scale of distance rates. For scale territory II, which, roughly defined, is that territory lying north and west of scale territory I and east of the Missouri River, we prescribed a scale of maximum distance rates 120 per cent of the basic scale. The rates in scale territories III and IV are respectively on higher bases than rates in scale territories I and II, but do not constitute fixed percentages of the basic scale. In addition to prescribing these scales of distance rates, 11 points of destination were selected and denominated key points. These key points include the most important markets and a few others. To these key points specific or so-called key-point rates were prescribed as maxima for interstate application from all the principal points of production. Some of these key-point rates were based exactly on the scales; others were slightly under or over the scale rates.

Following the publication of the tariffs containing the rates which the carriers had constructed in accordance with their interpretation of our order, numerous complaints were received from shippers. These complaints were based chiefly upon alleged

[1] 52 I. C. C. 225 (February 17, 1919).

failures of the carriers to observe our order. Some complaints were also received with regard to the effect of our order. Probably the most prolific cause of complaint was the manner in which the carriers had ascertained distance for the fixation of the scale rates between specific points. By our order we had required the carriers to use as a measure of the scale rates the distance via short-line workable routes. The use in our order of the term "short-line workable route" was not novel to the case, and it was not anticipated that any great amount of difficulty would be experienced in checking in rates in accordance with this method of measuring distances. The carriers seem to have construed short-line workable distance to mean distance via existing routes ordinarily and customarily used for the movement of shipments. Certain of the shippers, on the other hand, contend that the term means distance via the shortest possible routes. That the construction placed on our order by the shippers is not justified is evidenced by the illustration of a short-line workable route given on page 240 of our original report where, in fixing the short-line workable route from Newaygo, Mich., to Milwaukee, we used the single line, although a route shorter by 20 miles could have been constructed by including two lines.

What the Commission had in mind was the shortest distance via reasonable and practicable routes. Such routes might or might not be the routes via which the carriers ordinarily move the traffic. They might or might not be the shortest possible routes. It was expected that fair judgment would be exercised in ascertaining each short-line workable route, and that when such route had been ascertained the distance via that route would be made the measure of the rate. That the carriers have not complied with our order as to some rates seems certain. For instance, from the Kansas gas belt to stations north of Superior, Nebr., the carriers have apparently considered the route via Kansas City as the short workable route and have checked in the rates accordingly, whereas there is a much shorter route available through Superior. The possible latitude of interpretation inherent in the term "short-line workable route" and the divergence of opinion between shippers and carriers as to its meaning and application, have led us to the conviction that a more definite rule of measuring distance for the fixation of the rates is desirable.

The rates prescribed for scale territory I were, at the time of construction, on a substantial level with cement rates in central

freight association territory. Subsequently the cement rates in central freight association territory were increased 1 cent per 100 pounds in accordance with our decision in *The Fifteen Per Cent Case*, 45 I. C. C., 303. A similar increase was not made in the scale I rates prescribed in our previous report herein. Both the central freight association territory rates and the rates prescribed in our order herein have been increased 2 cents per 100 pounds in compliance with General Order No. 28 of the Director General of Railroads. This order will be hereinafter referred to as Order 28. Rates in central freight association territory are now substantially on the same level with the rates we prescribed for scale territory II particularly for the shorter distances. It follows that the rates in scale territory I are on a disproportionately lower level than the rates in the territories lying on the east and on the west.

The conditions above described led us, on October 7, 1918, to issue an order citing the parties to show cause, on November 9, (1) why scale territories I and II should not be consolidated upon the basis of scale II, (2) why in the application of the scales the shortest possible route between points of origin and points of destination should not measure the distance which shall determine the rate, such route to be (*a*) the shortest possible route via switch connections now existing, or (*b*) the shortest possible route via switch connections which may now or hereafter exist, and (3) why an arbitrary should not be added for a joint line haul, subject to the shippers' right to the lowest rate within the territory traversed by the shortest possible route.

At the argument upon the rule to show cause the parties were given an opportunity to discuss not only the propositions set forth in the rule but also several other collateral matters, which will be hereinafter commented upon.

Little objection developed on argument to the suggested consolidation of scale territories I and II. In fact there was general agreement that this consolidation should be made. We are of opinion that these territories should be consolidated and that the scale rates effective in scale territory II should be applied . . . in the consolidated territory, and we so find.

There was also quite general agreement among the cement interests that the shortest possible routes via existing or future switch connections should measure distance for the fixation of the scale rates. The carriers opposed this plan chiefly on the ground of the labor that would be entailed in ascertaining the shortest

possible routes. An instance was cited where, in attempting to ascertain the shortest possible route between two points, 19 possible routes were found. It was also stated that in ascertaining the shortest possible route from Hannibal, Mo., to five points of consumption in Iowa, Wisconsin, and Illinois, the services of an employee skilled in such work were utilized for more than 10 hours. Counsel for the carriers contended that to require the carriers to work out the short routes to all points within this vast territory, from the numerous points of production, would place upon the carriers an unwarranted burden, especially at this time of diminished clerical forces. That the task of ascertaining the short route distance is one of magnitude must be conceded, but we are not impressed with its impracticability provided a reasonable limit is set upon the number of lines to be embraced in such short routes. Neither do we believe that the task will be found as burdensome as anticipated by the carriers. Work of this character can be done in cumulative fashion, determining concurrently the short-route distances to a number of points. We are of opinion that distance via the shortest possible routes embracing as a maximum the lines or parts of lines of no more than three carriers via existing connections for interchange of carload traffic should be used as the measure of the scale rates in lieu of the short-line workable route distance prescribed by our previous report and order, and that it will not be necessary to revise the rates every time a new connection is installed. The use of the short-route distance is merely for the purpose of fixing a measure of the rates and does not necessarily govern the routes traversed as an operating matter. If in checking in the shortest route the lines of the same carrier are used twice in constituting different sections of the route, the two sections of the same carrier's line shall count as two of the three factors contemplated by the rule. . . .

The western boundary of scale territory II was placed at the Missouri River. The Kansas gas belt was, however, given scale II rates into scale territory II. At the argument a representative of the Kansas gas-belt mills contended that the location of the boundary of scale territory II at the Missouri River and the placing of the gas-belt mills in scale territory III, subjected those mills to the payment of prejudicial rates to points in scale territory III. It was contended that traffic conditions in eastern Nebraska and eastern Kansas are such as to justify in this territory as favorable rates as fixed for the territory between the rivers. In our original

report we found that the density of traffic in southeastern Kansas was fairly comparable with the density of traffic between the rivers. The density of population in the eastern portions of Kansas and Nebraska seems also to compare favorably with the density of population in Iowa. A representative of the Lincoln, Nebr., Commercial Club appeared at the argument and asked to be heard on the matter of rates to Lincoln from the gas belt. He contended that the present rates placed Lincoln at an undue disadvantage in marketing cement in eastern Nebraska in competition with Omaha. The present rate from the gas-belt mills to Lincoln is 15.5 cents. To Omaha, which is one of the key points, we fixed a rate of 11 cents, or slightly under scale II. This rate has been increased to 13 cents, so that there is a differential of 2.5 cents between the rates to Lincoln and Omaha. While we are not to be understood as committing ourselves in any way as to whether eastern Nebraska and Kansas should be included in scale territory II, we are willing to consider an appropriate petition to reopen the case on this question.[1] . . .

[1] In a Second Supplemental Report, the Commission (69 I. C. C. 644) revised the findings of the original report, so as to require the application of an average of Scale II and Scale III rates between points in Nebraska, Kansas, and Missouri in Scale III territory; and to require rates in Scale IV territory not in excess of 120 per cent of the rates prescribed in the Second Supplemental Report for Scale III territory. This decision was the result of the invitation implied in the last paragraph quoted above. The gas belt mills and the Chamber of Commerce of Lincoln, Nebraska, filed a joint petition which the Commission considered in its opinion. The distance tables after giving effect to both supplemental opinions and *Reduced Rates, 1922*, 68 I. C. C. 676, are given at p. 658 of the Second Supplemental Report, 69 I. C. C. 644.—Ed.

CHAPTER XI

GROUP RATE SYSTEMS [1]

1. The Texas Common Point Adjustment [2]

Harlan, *Commissioner:*

In view of the vigorous protests made by commercial organizations representing the towns affected, the Commission by its order of June 1, 1912, suspended certain commodity tariffs filed by the southwestern lines, the respondents herein, for the avowed purpose of restricting the area of what is known as the common point territory of Texas. The necessary consequence of the tariffs, if allowed to become effective, will be to put outside that territory and into the so-called differential territory a number of towns that for years have enjoyed common point rates.

The rate adjustment to Texas points has often been referred to as unusual and peculiar; as a matter of fact, it is unusual only in the extraordinary extent of the territory affected by the adjustment. It is really nothing more or less than a very broad rate group, not duplicated elsewhere in the country except by the even larger rate group established under the tariffs of the transcontinental lines. . . . The common point territory, as now constituted under the tariffs of interstate carriers, comprises all that part of Texas lying east of a line commencing at Quanah on the north and running thence in a southerly direction through Big Springs and San Angelo to Corpus Christi on the Gulf of Mexico. This western boundary is indicated on the accompanying map by the dotted line. In general, all points in this very large territory, 500 miles in extent from north to south and 450 miles from east to west, take

[1] See Vanderblue and Burgess, pp. 177–203.

[2] *Texas Common Point Case,* 26 I. C. C. 528 (March 11, 1913). The rates from a very large section of the United States are made with relation to the rates from St Louis. The different territories of origin are grouped, and rates from these groups are made by adding or subtracting fixed differentials to or from the St. Louis rates. This rate structure is discussed in detail in *Dallas Chamber of Commerce* v. *Atchison, Topeka and Santa Fé Railway Company,* 40 I. C. C. 619, from which the map of origin groups is taken. The competitive conditions out of which the common point rates grew are explained in *Dallas Freight Bureau* v. *Missouri, Kansas and Texas Railway Company,* 12 I. C. C. 427.—Ed.

the same commodity rates from any point in the United States on or east of the Missouri and Mississippi rivers. In the northern part of the territory is an area commonly known as the burnt district, to which lower rates are in effect from Kansas City and intervening territory. The territory lying west and south of the common point territory is known as differential territory, and to all points within it rates are made by adding differentials to the

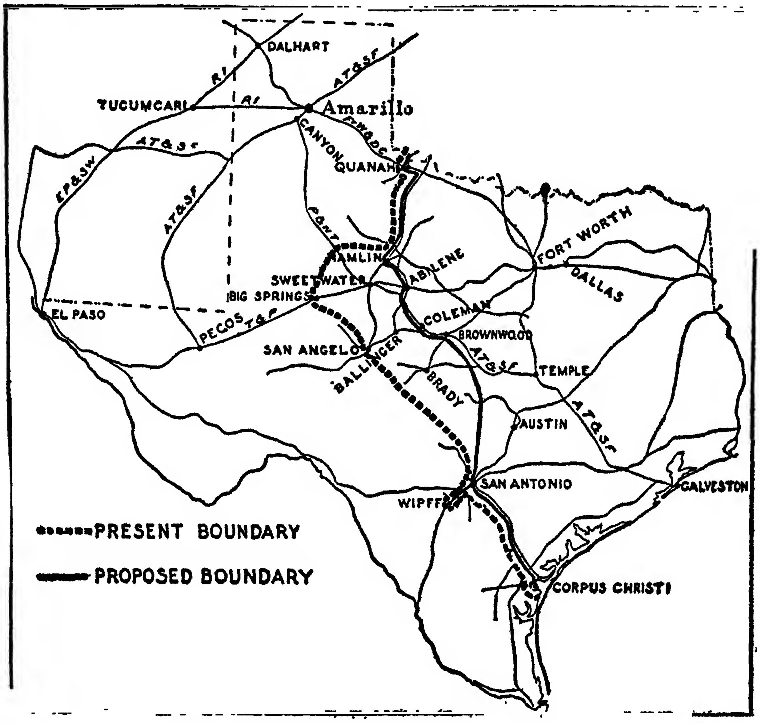


PLATE 12.—Texas Common Point Group.

common point rates. There is also a territory in the vicinity of Galveston and Houston to which rates lower than the common point rates are applied; but with these rates we are not concerned here. The average distance from St. Louis to Texas common points is 800 miles. . . .

The common point rate adjustment in Texas has been a matter of comparatively slow development. It originated out of the fact that interior Texas is accessible through so many gateways; traffic flows into all parts of the state not only by way of the ocean and

gulf and on the Red River, but over the rail lines entering the state through its eastern and northern boundaries. The competition of the carriers reaching the state from these different directions resulted in putting a large part of the state on the same rate level, and was largely, if not altogether, responsible for the successive extensions of the common point territory toward the west. Possibly the orders of the state commission respecting state traffic may have contributed to the extension of the common point territory for interstate traffic; but an experienced railroad witness said on the hearing that this was not the case. It is altogether clear, however, that this is an accurate view of the situation. Nevertheless, it is true that the successive extensions of the territory, so far as interstate traffic is concerned, have voluntarily been made by the carriers in the sense that they have not been required under any order of this Commission. In a number of cases before us communities in differential territory have demanded that they be included in common point territory, but in none of them did we find the record sufficient to justify such an order. So far as interstate traffic is concerned it appears, therefore, that the carriers have been forced by competition among themselves and by other conditions to enlarge the common point territory. The last extension was made on September 19, 1904, at which time the present western boundary line was established.

That extension took out of differential territory and put into common point territory certain towns, among which the most important were Sweetwater, Big Springs, San Angelo, Brady, and Ballinger. These communities have therefore enjoyed the common point rates for more than eight years. By the tariffs under suspension it is proposed now to raise their rates by restoring them to differential territory. As heretofore stated the present common point territory has been a matter of slow development. But the changes that have taken place in it have been in the direction of enlargement; there has been no restriction or drawing in of its boundaries. There is of record some vague impression that a restriction was attempted in 1906; but if it was made effective at all it was for a period of less than 40 days. The tariffs under suspension here are the first definite undertaking on the part of the carriers to narrow the area; it is proposed to do this by establishing the western boundary line farther toward the east, thus taking certain towns out of common point territory and to that extent broadening the so-called differential territory.

It is substantially admitted of record that the proposed increase in the rates of these towns, by taking them out of common point territory and putting them into differential territory, was not based on any real consideration of the merits of the new rates or upon any substantial consideration of the rate relation of those communities to other communities in common point territory. The fact is that recent railroad construction has left the respondents on the horns of a dilemma; they must either raise the rates of the towns in question by putting them out of common point territory and into differential territory, or they must lower the rates of Amarillo by taking it out of differential territory and putting it in common point territory. Being compelled by new conditions to accept one of these alternatives, the respondents frankly state of record that they took the course that would have the least effect upon their revenues. In other words, Amarillo has grown to such importance and has so large a traffic that the loss of revenues attending the lowering of its rates by putting it in common point territory would be substantially greater than the gain resulting from raising the rates of the points in question by putting them back into differential territory. The latter course was therefore adopted and is the purpose underlying the tariffs under suspension.

Should Amarillo be brought into common point territory the direct effect on its revenues, as estimated by the Santa Fe, will not exceed $25,000 a year. But the indirect effect, it is thought, will be of greater consequence for the reason that the Amarillo rates will have to be graded back into Oklahoma and Kansas. The Roswell rates, and rates into Roswell territory, will also be affected to some extent, a relation of rates between Roswell and Amarillo having been established in *Roswell Commercial Club* v. *A., T. & S. F. Ry. Co.*, 12 I. C. C., 339. It is clear that the effect on the revenues of the other southwestern lines will not be so great as upon the revenues of the Santa Fe. The estimates offered by the Santa Fe of the effect on its revenues from the inclusion of Amarillo in common point territory include both class and commodity traffic. It may be well to add that the class rates to common point territory are still under the control of our orders in the *R. R. Commission of Texas* v. *A., T. & S. F. Ry. Co.*, 20 I. C. C., 463; it is understood, however, that upon the expiration of the order in May next the respondent lines propose to take similar steps to narrow the common point area with respect to class traffic also.

Practically the only effort made by the respondent carriers to meet the burden cast upon them by the statute, of justifying this proposed increase in the rates of a number of more or less substantial communities, was by showing that unless the rates are increased another and a competing community will be entitled to lower rates than it now enjoys. It was suggested that the logical western boundary of the common point area would be the line established by the carriers in 1887, just west of Fort Worth; that, however, is not the line proposed by the tariffs under suspension. It was also said that the country surrounding the towns in question had been so affected by droughts during the past four or five years as to modify its outlook as an agricultural country and cause the farmers to some extent to revert to cattle grazing. But an earnest protest was made at the hearing against this view, and certainly the enthusiastic descriptions of the country by some of the witnesses gave no indication of any lack of hope in its steady and sound development. It was also asserted that new settlers are no longer coming into the country and that there has been an actual decline in the population of some of these towns. It must be remembered however, that the towns in question have long been in common point territory; that they were put there voluntarily by the carriers, and because, in the judgment of the carriers, their relation to competing points in the territory not only justified but required them to be put on the same rate basis. It is true that the absence of rain for some years has slowed up their growth, which prior to that time had been rapid and continuous. This burden these communities have been compelled to bear, and must continue to bear should it develop that there has been a permanent change in climatic conditions. The effect of the drought is also shown in the revenues of the carriers; but, apparently on the assumption that the droughts will continue for the indefinite future, the carriers, instead of sharing the consequences with the shippers, now seek to relieve themselves of the burden by increasing their rates. These climatic conditions have been emphazised by the respondent lines, but they have not undertaken to show any other change in the relations between the towns in question and other communities that are to remain in common point territory. All these trading centers are still in competition with one another, and the conditions which caused the carriers to put them on the same rate basis with one another still exist.

An attentive examination of the record has led us to the con-

clusion that the carriers have not justified the proposed increased rates for these towns, and have therefore failed to meet the burden

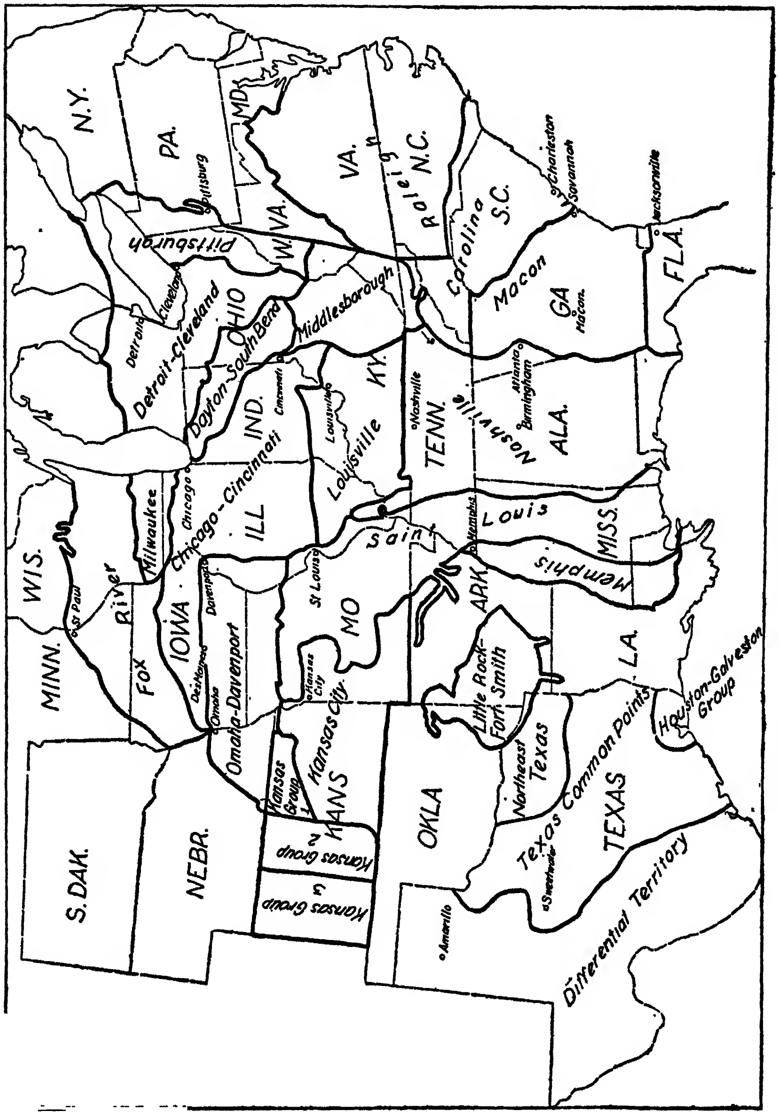


PLATE 13.—The Texas Interstate Rate Groups.

of proof imposed upon them by the statute. When first put into common point territory the traffic of these communities was substantially less in volume than at this time. They contend,

therefore, that if they were then entitled to common point rates they are much more entitled to them now. They also call attention to the fact that they were voluntarily put in common point territory by the carriers, and that their business had been adjusted to that rate basis. They regard it as an especial hardship now to have higher rates added to the burdens that the successive droughts have put upon them. Moreover, it appears that in some cases the short-line mileage is less now than when they were first put into common point territory. The short-line distance from Kansas City to San Angelo, for example, was then 857 miles. It is now 732 miles. From St. Louis the short-line distance was 1,059 miles. It is now only 940 miles. There is another fact upon which some stress is laid: Most of these towns have contributed to the new construction of the carriers, and in addition have subscribed for substantial amounts of bonds. Ballinger paid $80,000 to the Abilene & Southern; Brady gave $45,000 in cash to the Santa Fe, and in addition donated to it its entire right of way through the county and town and also its station grounds, at an additional expense of $45,000. San Angelo contributed to the Kansas City, Mexico & Orient $100,000 in money; it also donated its right of way through the county and bought $300,000 of its bonds. When the Santa Fe built its line from San Angelo to Sterling City in 1910, San Angelo donated the right of way and $40,000 in cash. The droughts have interfered with the payment of some of these amounts; in other cases the carriers have extended the notes, and in some instances have canceled the pledges. It is but proper to state these facts, although we have attached no importance to them in reaching the conclusion that the plan proposed by the respondents, of putting these towns back into differential territory, has not been justified of record. We find from the evidence adduced of record that the rates proposed by the respondents on the traffic of the communities in question are excessive and unreasonable, and that any rates upon such traffic for the future in excess of the rates on the traffic of adjacent points in the common point territory of Texas will also be unduly discriminatory.

The common point territory is perhaps unduly large and we have so intimated on various occasions. Its extension has not been favored by this Commission. Nevertheless when the southwestern lines prepare to narrow its boundaries they must do so in fair regard to the rights of the communities which they propose to exclude, in their relation to the communities which they

propose to retain within the favored area. They have failed to do this in these tariffs. They have simply attempted to keep Amarillo out of common point territory by excluding its immediate competitors, overlooking the fact that these competitors of Amarillo have rights growing out of their relation with other communities that are still to remain in common point territory. The difficulty here is that the respondent lines have not gone far enough; they have made no effort to reform the boundaries of the common point territory on proper and consistent grounds but only an effort so to reform it as to keep Amarillo out.

The intervention of Amarillo herein asking that it be given common point rates is the real issue before us. The tariffs by which it is proposed to exclude certain competing towns from common point territory were filed by the southwestern lines simply in anticipation of a demand on the part of Amarillo for common point rates. The same relief was demanded by Amarillo in 1906 in *Nobles Bros. Grocer Co.* v. *F. W. & D. C. Ry. Co.*, 12 I. C. C., 242; and a proper understanding of the present situation requires a brief reference to the conditions then existing.

At that time the rails of the Santa Fe and of the Texas & Pacific in this part of Texas were substantially 250 miles apart; between Amarillo on the Santa Fe and Sweetwater on the Texas & Pacific was a vast stretch of country without a railroad and devoted almost exclusively to grazing. There were a few small settlements but no town of importance. On this record it is shown that there were no wholesale houses at Sweetwater until after our decision in that case, and only two jobbing houses at Big Springs. There was no town of commercial importance on the Texas & Pacific, and the wagon roads, leading from Amarillo into this country to the south, were substantially better than the country roads extending northward from points on the Texas & Pacific. The result of these conditions was that the merchants of Amarillo with their wagons were early in control of the jobbing business throughout this area. In consequence Amarillo's population rapidly increased, numerous jobbing houses were established there, and in 1906 we were asked in the case cited to extend the limits of common point territory by including Amarillo within it. We denied relief, but because of its proximity to Kansas City we held that Amarillo ought to have the so-called burnt district rates.

Even while that case was pending before us the relation of Amarillo to the general situation had begun to change. The

Pecos & North Texas, now a branch of the Santa Fe, was building southward from Amarillo in the direction of Sweetwater; and shortly after our decision was announced that line was operating trains into Plainview, 74 miles south of Amarillo. It reached Lubbock, 121 miles south of Amarillo, at the close of the year 1909, and entered Sweetwater in July, 1911. As construction progressed settlers came into the country in large numbers, ranches were broken up into farms, and agriculture took the place of cattle grazing as the principal occupation in the country districts. In the meanwhile Sweetwater has grown from a hamlet of 1,000 persons to a thriving town with a population of 5,000 inhabitants. Jobbing houses have been established there, and they reach out into the territory to the north as keen rivals of the merchants of Amarillo. At this time it in fact appears that Sweetwater is the most active competitor of Amarillo in the country that lies between them. Sweetwater has an advantage over Abilene and Big Springs in that it has a direct route, over one line only, into this territory to the north, while the route from the other two points is indirect and involves a two-line haul; under the state tariffs their distributing rates are therefore higher. The most important factor in the general situation, however, is that Sweetwater also has an advantage over Amarillo in that it is within the common point territory while Amarillo is in differential territory. Amarillo's rates are higher, although its haul is shorter. The indication of record is that a large part of the merchandise distributed in this extensive territory between Amarillo on the north and Sweetwater on the south moves over the Santa Fe rails through Amarillo. The Amarillo rates being higher than those of Sweetwater are therefore in conflict with the fourth section, although protected for the present by fourth-section applications.

These very material changes in conditions at Amarillo and in its relation to the surrounding territory prepared the carriers for the demand made upon them by the merchants of Amarillo, soon after our decision in the case last cited, for an entire readjustment of the rate situation. There can be no doubt at all from the record that the southwestern lines serving Amarillo felt that there was some justice in its demands. It is not necessary, however, to recount the history of the negotiations that followed. They were somewhat protracted, but finally reached a point where both sides were ready to make concessions. Growing out of the negotiation came a suggestion by the carriers that if the commercial inter-

ests of Amarillo would select a list of the commodities in which they were most interested the carriers would endeavor to establish rates upon them on a parity with the common point rates. It should be borne in mind that the jobbers of Amarillo were not contending that their rates were unreasonable, but only that they were discriminatory as compared with the rates enjoyed by Quanah, Sweetwater, and other points in common point territory. The merchants therefore presented such a list of commodities, and we think it fairly established by the record that there was practically an understanding that, on these commodities, rates would be fixed on a parity with common point rates. This plan, however, was never made effective.

Although there are some indications that the severe droughts of the last five years retarded the development of Amarillo as they have retarded the development of the surrounding country, nevertheless during the last 10 years its population has increased from 1,400 to 14,000. It is one of 11 first-class post-offices in the state of Texas; it has five banks, with aggregate deposits in November, 1912, of over $3,000,000; it is reached by four lines of railroad, the Rock Island, the Fort Worth & Denver City, the Southern Kansas of Texas, and the Pecos & North Texas, the last two being now in the Santa Fe system. It is a large jobbing center, distributing in less-than-carload shipments traffic that comes inbound in carload lots. There are five or six wholesale groceries there, one of them doing a business of over $1,000,000 a year. One hardware firm has a business approximating $425,000 a year. In addition there are wholesale dealers in dry goods, fruits, bicycles, agricultural implements, and other substantial articles of commerce. It is a common point with respect to state traffic and has been since 1905; it therefore enjoys common point rates from Galveston and other Texas ports. A hardware merchant testified that 40 per cent of his shipments came through the gulf ports. It takes burnt-district rates along with Sweetwater and Quanah. But on traffic from St. Louis and defined territories it takes a differential over common point rates, to its substantial disadvantage as a jobbing point.

The merchants and shippers of Amarillo have presented their case with great earnestness and in the confident belief that the relief prayed must necessarily be granted on the showing made. On the other hand, the defense offered by the respondents is directed largely to the consequences of such a step rather than to

the merits of the demand. Moreover, although in their conferences and correspondence with the representatives of Amarillo the southwestern lines have shown a clear appreciation of the changed conditions above described and of the necessity of giving Amarillo some relief, nevertheless they have hesitated to make it a common point, not because of the direct effect of such a readjustment of rates upon their revenues but rather because of its indirect effect. They point out that the present area of the common point territory is larger than any state in the Union except Colorado, Montana, and New Mexico, and embraces a large part of the population and area of the state. The fear expressed by the carriers is that, if Amarillo is given common point rates, the result will be finally to extend such rates to the entire state. Dalhart, for example, on the Rock Island, 82 miles northwest of Amarillo, has always had the same rates as Amarillo; and in *Roswell Commercial Club* v. *A., T. & S. F. Ry. Co.*, 12 I. C. C., 339, as hereinafter stated, we fixed a relation of rates between Amarillo and Roswell; lower rates to Roswell would therefore follow a lowering of the rates to Amarillo. It is contended also that towns on the Rock Island between Amarillo and Texola, and on the Fort Worth & Denver City between Quanah and Amarillo, would have to be put in common point territory; and that points westward and southward, now taking differentials grading up from Amarillo, would require revised rates. The estimated loss for the past year, of the Southern Kansas of Texas and the Pecos & Northern, on the basis of all these rate revisions that the carriers assert would necessarily follow the granting of common point rates to Amarillo, was $25,517.76.

After a careful examination of the record we are not prepared fully to grant the prayer of the intervening petition of Amarillo. We have said that the common point territory of Texas has been enlarged from time to time, but has never been restricted. The statement is not altogether accurate. As a matter of fact an effort to force a reduction in its divisions caused the Fort Worth & Denver City to make certain arrangements with its connections that finally resulted in extending common point rates to Amarillo. This took place in November, 1891, and Amarillo continued to have the benefit of a rate parity on interstate traffic with towns in common point territory until June 10, 1895, a period of nearly four years. But this occurred many years ago and the conditions that brought it about were special in character. It is an incident

in the rate history of Amarillo to which we can attach little importance now. The rights of Amarillo must be determined in the light of present conditions. Viewed from that standpoint there can be no doubt that we would not hesitate on this record to put Amarillo on a parity with Quanah, for example, on traffic moving from such a distance as St. Louis and the defined territories, if those two points could be considered by themselves and wholly apart from other points in Texas. But the rights of Amarillo can not be considered without giving some heed to the conditions that surround it. Quanah is in the common point territory, an already unusually extensive rate group which on strong grounds we have been and still are reluctant to enlarge. Such rate structures must have boundaries somewhere. Their limits must be prescribed and definitely located; and wherever the line may be drawn the point next beyond it is necessarily on a higher rate level. In some cases the increase is harshly abrupt. This is the plight of Amarillo. But now to put it in the favored territory, not improbably would soon result in making the common point area coterminous with the boundary lines of the state. This we think should be avoided and we are disinclined to take any step tending toward such a result. On the contrary there are substantial reasons, although not developed on this record, for thinking that the present common point territory, so far from being enlarged, could well be broken up into several different zones or groups, and this some day may be found to be necessary.

Nevertheless we think on this record that Amarillo is entitled to some relief. Although located well to the north in that part of the state commonly called the Panhandle, it is a gateway through which flows a growing volume of traffic into Sweetwater and other jobbing points in the common point area; and apparently it is the route over which a large part of the traffic now moves when destined to the territory intervening between Amarillo and Sweetwater. All these and other facts of record, as well as the principle involved in the fourth section, lend no small force to Amarillo's contentions. But in view of the far-reaching consequences of an order putting it in common point territory we are not prepared to take that course. As we have just stated it is entitled on the record to some relief; this is clearly demonstrated. But substantial justice will be done, we think, by requiring the southwestern lines to carry out the suggestion, at one time practically agreed upon, of giving to Amarillo rates upon certain commodities on a parity

with common point rates; to that extent violations of the fourth section will be avoided. We shall expect the respondents to arrange to do this promptly without an order; but we shall reserve the record for such further consideration as the attitude of the carriers with respect to this suggestion may seem to make necessary.

2. Percentage Groups [1]

Meyer, *Commissioner:*

This case was made the subject of a proposed report which was served upon the parties. Exceptions were filed by the complainants and the Michigan City intervener and oral argument had.

The initial complainant herein is a corporation organized to further the commercial, industrial, and municipal interests of South Bend, Ind. Its members and the other complainants herein are corporations, partnerships, and individuals having their principal places of business for the manufacture and sale of various commodities at South Bend, Mishawaka, Elkhart, Goshen, and Napanee, Ind. The complaint of these cities is that for the transportation of class and commodity traffic between those cities and points in trunk line territory and New England territory shippers are subjected to the payment of rates which are unjust and unreasonable, absolutely and relatively, in violation of the act to regulate commerce and the federal control act; and which are unjustly discriminatory and unduly prejudicial and in violation of the long-and-short-haul provision of the fourth section of the act to regulate commerce.

The class rates paid by the complainants between South Bend and the associated cities and New York, N. Y., are, in cents per 100 pounds, for the six classes, as follows:

Classes	1	2	3	4	5	6
Rates	108	95	72	50.5	43	36

Between trunk line territory and central territory, rates are adjusted in relation to the scale of rates applicable between Chicago and New York, which are regarded as base rates and Chicago as a 100 per cent point. Points in central territory are placed in groups which take percentages of the base rates, theoretically in

[1] *South Bend Chamber of Commerce* v. *Director General*, 57 I. C. C. 215 (March 2, 1920); for the report of the Commission on further hearing, see 61 I. C. C. 67 (March 15, 1921). For general discussion of the percentage rate structure, see Jones, pp. 148–157, and Vanderblue and Burgess, pp. 191–196, from which the map here reproduced is taken.—Ed.

the proportions that the short-line distances between such points and New York bear to the short-line distance between Chicago and New York. The percentages on east-bound traffic are not always the same as on west-bound traffic. Rates between points in central territory and points in trunk line territory, other than New York, are made differentially higher or lower than rates to or from that point.

Under this adjustment the complaining cities are grouped with other points in northern Indiana taking 96 per cent of the base rates. Complainants contend that their manufacturers and jobbers compete with manufacturers and jobbers of similar character, particularly those located in the central and northern portions of the states of Ohio and Indiana and that portion of the southern peninsula of Michigan lying immediately north of the complaining cities; that the revenue per mile of haul under rates between the competitive territory specified and New York is lower than that under rates paid by the complaining cities; that their favorable location on the great channels of through transportation between Chicago and New York entitle them to rates made 92 per cent of the base rates, which would reduce their rates to and from New York in cents per 100 pounds on the respective classes in the following amounts:

Classes....................	1	2	3	4	5	6
Amounts..................	4.5	4	3	2	1.5	1.5

The Chamber of Commerce of Michigan City, Ind., composed of merchants and manufacturers of that city, filed a similar complaint, which was permitted to be filed as of the nature of an intervention. Michigan City is grouped with Chicago and other points in the 100 per cent group. It, too, is seeking a reduction of its percentage to 92 per cent, which would result in reductions in the rates in the following amounts:

Classes....................	1	2	3	4	5	6
Amounts..................	9	8	6	4	3.5	3.5

In the *Michigan Percentage Cases,* 47 I. C. C., 409, we held that rates to certain points in Michigan were unduly prejudiced to such cities, and that the prejudice could be removed only by reducing the percentages of the Michigan groups. Grand Rapids, Kalamazoo, Marshall, Battle Creek, and other points in Michigan in the 96 per cent group were reduced to 92 per cent. One effect

of our order in that case was the division of the former 96 per cent group at the Indiana-Michigan state line. After the filing of the complaint in this case, in a petition to reopen the *Michigan Percentage Cases, supra,* the Director General averred, among other things, that the discrimination alleged by the complainants herein, if any existed, was due solely to the fact that the defendants in that case had obeyed our order and that the only proper method of removing such discrimination was to change the percentage bases in effect in Michigan, and especially in the 92 per cent group. The petition was denied. Some of the complainants in that case, interested in the preservation of the adjustments there obtained, intervened in the present case.

South Bend, Mishawaka, Elkhart, and Goshen are in the central portion of northern Indiana near the Indiana-Michigan state line. South Bend is less than 7 miles south, and Niles, Mich., in the 92 per cent group, is 5 miles north of that line. South Bend is 96 miles east of Chicago. By railroad Mishawaka is 4 miles east of South Bend, but its suburbs adjoin those of South Bend and the two cities are practically one industrial community. Elkhart is 11 miles and Goshen 31 miles east of Mishawaka. The complaining cities are located between Chicago and Toledo, Ohio, on the main line of the New York Central Railroad. South Bend and Mishawaka are also on the line of the Grand Trunk Western Railway between Chicago and Kalamazoo, Mich. Goshen and Elkhart are served by the Michigan division of the Cleveland, Cincinnati, Chicago & St. Louis Railroad operating from Benton Harbor, Mich., to Louisville, Ky. A branch of the Michigan Central connects South Bend with the main line of that company. In addition other north-and-south lines such as those of the Lake Erie & Western, New Jersey, Indiana & Illinois railways and the Pennsylvania Company reach South Bend, and in connection with eastern lines of the Baltimore & Ohio Railroad, Wabash Railroad, and the Pennsylvania Company form other routes. Napanee is on the main line of the Baltimore & Ohio Railroad between Chicago and Baltimore, Md. It is 9 miles west of Milford Junction, Ind., which is 11 miles south of Goshen.

Michigan City is located on the shore of Lake Michigan, 56 miles east of Chicago and about 10 miles southwest of New Buffalo, Mich., a point in the 92 per cent group. It is on the main lines of the Michigan Central and Pere Marquette railroads. It is also served by the north-and-south lines of the Lake Erie & Western

and the Chicago, Indianapolis & Louisville railroads and by traction lines.

Under the formula used in making these percentage-group rates, the desired percentage is obtained by deducting a fixed terminal charge of 6 cents per 100 pounds from an assumed rate from Chicago to New York of 25 cents per 100 pounds; the remainder is divided by the short-line distance from Chicago to New York; the result is multiplied by the short-line distance of the point from which the percentage is sought from New York, the terminal allowance is again added and the percentage which the resulting rate bears to the 25-cent rate is the percentage to be used. Prior to *The Five Per Cent Case,* 32 I. C. C., 325, the sixth-class rate from Chicago to New York was 25 cents per 100 pounds. Due to the increases allowed in that case, in *The Fifteen Per Cent Case,* 45 I. C. C., 303, and General Order No. 28 of the Director General of Railroads, the present sixth-class rate from Chicago to New York is 37.5 cents per 100 pounds, or 50 per cent higher than the 25-cent rate. Consequently in their exhibits complainants have deducted 9 cents as a terminal allowance from the sixth-class rates, and, following the formula described, compared the resulting revenue per mile of haul at the complaining cities with that at points in Ohio and Michigan, and showed that the revenue under rates to the complaining cities is higher than that from rates to points in Ohio and many of the Michigan points. Defendants contend that this manner of obtaining rates does not correctly disclose the relative situation for the reason that the revenue per ton per mile decreases as the distance increases only because the terminal allowance, a constant factor, is necessarily proportionately diminished as the distance increases. They therefore compare the revenue per ton per mile under the fifth-class rates, and the revenue per 100 pounds per mile under the sixth-class rates, showing that with few exceptions the revenue per ton per mile and per 100 pounds per mile from rates to the complaining cities is lower than from rates to points in Ohio. The fifth-class rates were used for the reason that over 50 per cent of the carload ratings in the official classification are of that class, whereas but 11 per cent are of sixth class.

In many instances the western edges of the rate groups are north-and-south lines of railroad, and many important points formerly recognized as basing points, such as Cleveland and Toledo, are in the western part of the groups. In a grouping

system, it necessarily follows that rates at such points are lower, distance considered, and the revenue per ton per mile less than at other points in the group.

Michigan City is on the extreme eastern edge of the 100 per cent group. To grant it the relief prayed, a 92 per cent basis, would make the revenue per ton per mile under rates between New York and Michigan City lower than that under rates between New York and Chicago. Rates between New York and Michigan City are the same as the rates between New York and Chicago. Rates between Michigan City and the west are higher than those between Chicago and the west. Gary, East Gary, and Porter, Ind., are in the Chicago switching limits, Michigan City is not. Each case must be considered on its merits and whether the adjustment between Michigan City and the west is unreasonable or prejudicial is not in issue here.

West of the line of the New York Central running north from White Pigeon to Grand Rapids, lie 10 cities which have rates that yield lower revenue per ton per mile from the fifth-class rates from and to New York than do the rates to and from South Bend and associated cities and Michigan City. It is practically admitted by the defendants that these points have a basis of rates which is lower than that to which their location entitles them. That the rate disparity between Michigan City in the 100 per cent group, and New Buffalo in the 92 per cent group, is indefensible is admitted.

Because of deflation in the percentages and consequent lower rates to and from points in Michigan beyond South Bend, Elkhart, and Goshen, departures from the provisions of the fourth section exist. The Cleveland, Cincinnati, Chicago & St. Louis Railroad runs from Benton Harbor, through Niles, Elkhart, and Goshen, and south through Claypool, Bolivar, and New Paris, Ind., its junctions with the New York, Chicago & St. Louis, Erie, and Wabash railroads. These junctions, also Marion, Milford Junction, and Plymouth, Ind., in connection with eastern carriers, are used in making through rates via which Niles and Benton Harbor are accorded through rates on the basis of 92 per cent of the base rates.

The Grand Rapids branch of the New York Central Railroad from Elkhart to Grand Rapids runs through White Pigeon, Three Rivers, Kalamazoo, and Allegan. To and from the territory along this branch, in the 92 per cent group, through traffic is

handled via Goshen and Elkhart, because it is more economical to do so than to move it via the shorter route of the same line via Grand Rapids, Lenawee Junction, and Toledo. After the *Michigan Percentage Cases, supra,* the interested carriers represented to us that departures from the long-and-short-haul provision of the fourth section of the act would be created and departures increased at intermediate points in Ohio and Indiana in complying with the decision. We accordingly authorized temporary relief from the application of the fourth section in this respect.

Defendants urge that if the basis sought by complainants is granted, other cities and towns in central territory, the percentages of which are not exactly upon the formula basis, would seek similar relief, and that a strict application of the percentage formula through the territory would involve serious reductions of revenue. They also call attention to the fact that many of the railroads serving the complaining cities are among those which failed in 1918 to earn their standard returns. While these are proper elements for consideration in determining the reasonableness of rates, they constitute no bar to the granting of relief if rates are shown to be relatively unreasonable or unduly prejudicial.

Defendants also urge that the preponderance of tonnage is eastbound rather than westbound; that overhead tonnage transported from the western edge of central territory, through Illinois, Indiana, and Ohio, increases very materially in the latter state; that the Mahoning and Shenango Valleys in Ohio and Pennsylvania, the great iron and steel producing section of the country, produce enormous volumes of tonnage both for eastbound and westbound movements far in excess of all tonnage produced in Indiana, and that basing points in Ohio may logically be accorded rates which are related more closely to those which an exact application of the percentage formula would afford them than could be claimed by the cities of Indiana with their comparatively lighter tonnage.

Upon consideration of the whole record, we are of the opinion and find that the rates between Michigan City, South Bend, Mishawaka, Elkhart, Goshen, and Napanee, on the one hand, and points in eastern trunk line and New England territories, on the other, are relatively unreasonable and unduly prejudicial to such cities and unduly preferential of cities in central and northern Ohio, and in Michigan, west of the line of the New York Central Railroad from Elkhart to Grand Rapids and south of the

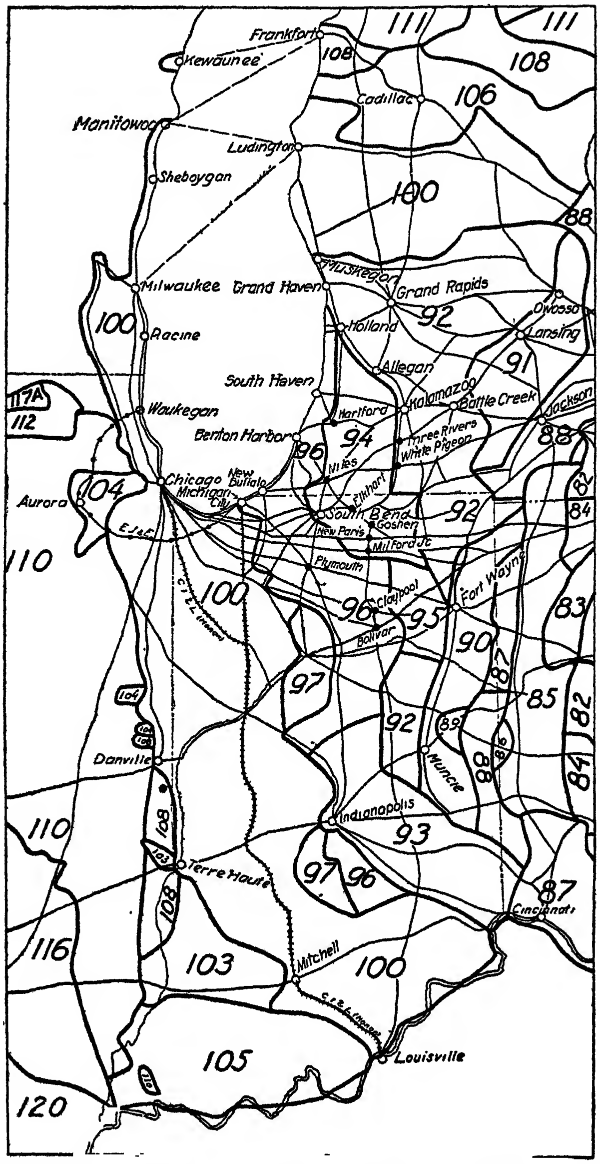


Plate 14.—Percentage Groups in Indiana, Illinois, and Michigan, after Adjustments Required in the *South Bend Case.*

line of the Grand Trunk Western from Grand Rapids to Grand Haven.

The undue prejudice with respect to Ohio points should be removed by reducing the percentage of South Bend and associated cities to 94 per cent, and of Michigan City to 96 per cent, and with respect to the southwestern Michigan points can be removed by increasing the percentage of Niles, Buchanan, Hartford, Holland, and points east thereof to the line above described to 94 per cent, and points west thereof to 96 per cent.[1]

The short-line routes to Kalamazoo and Grand Rapids and points on and east of the line above described do not pass through the complaining cities, and with rates to both groups properly adjusted, it is not apparent that the complaining cities would be injured by allowing traffic destined to points properly entitled to lower rates to move over routes through the higher-rated group, and as to these points we shall allow the temporary relief granted in Fourth Section Order No. 7149 to stand.

The routes and distances to points west and south of the lines above described from Elkhart to Grand Haven are not such as to justify lower rates than at the complaining cities, and that portion of the fourth section order permitting the maintenance of lower rates to such points than to intermediate points will be revoked.

Appropriate orders will be entered.

[1] In its report upon further hearing the Commission modified this decision by eliminating Holland from the 94 per cent group, as shown on the map (Plate 14), 61 I. C. C. 67, 72.—Ed.

CHAPTER XII

THE LONG AND SHORT HAUL PRINCIPLE [1]

1. The Southern Rate Structure

A. THE MURFREESBORO CASE: ORIGINAL OPINION [2]

McChord, *Commissioner:*

The complaint in this proceeding alleges that the class and commodity rates to Murfreesboro, Columbia, Dickson, Gallatin, Lebanon, and Watertown, Tenn., from the points of origin hereinafter set forth are unreasonable and as compared to the rates to Nashville, Tenn., are unduly prejudicial to the points named. It is further alleged that certain rates involve departures from the long-and-short-haul clause of section 4 of the act to regulate commerce. Rates which shall not exceed those contemporaneously in effect to Nashville, and reparation, are asked. Intervening petitions were filed by the Traffic Bureau of Nashville and the Tennessee Manufacturers' Association. The former opposes the relief sought, and the latter does not support or oppose the prayer of complainants. Appropriate fourth section applications were set for hearing with the complaint. . . .

Murfreesboro is 32 miles southeast of Nashville, on the Nashville, Chattanooga & St. Louis Railway; Columbia is 46 miles southwest of Nashville, on the Louisville & Nashville Railroad and Nashville, Chattanooga & St. Louis Railway; Dickson is 42 miles west of Nashville, on the Nashville, Chattanooga & St. Louis Railway; Gallatin is 27 miles northeast of Nashville, on the Louisville & Nashville Railroad; Lebanon is 31 miles east of Nashville, on the Tennessee Central Railroad and Nashville, Chattanooga & St. Louis Railway; and Watertown is 45 miles east of Nashville, on the Tennessee Central Railroad. Nashville is on the Cumberland River, and is served by all of the railroads serving the various complaining points. The accompanying map illustrates the situation. In 1910 the population of these points

[1] See Vanderblue and Burgess, pp. 157–176, and Jones, pp. 216–217, 255–256.

[2] *Murfreesboro Board of Trade* v. *Louisville and Nashville Railroad Company*, 55 I. C. C. 648 (December 8, 1919). See Jones, pp. 157–166, and Vanderblue and Burgess, pp. 196–201.

was: Nashville, 114,899; Murfreesboro, 4,679; Columbia, 5,754; Dickson, 1,850; Gallatin, 2,399; Lebanon, 3,659; and Watertown, 517.

The points of origin involved are the eastern ports; interior eastern cities; Buffalo-Pittsburgh territory; Virginia cities; south Atlantic ports; interior southeastern points; Gulf ports; St. Louis,

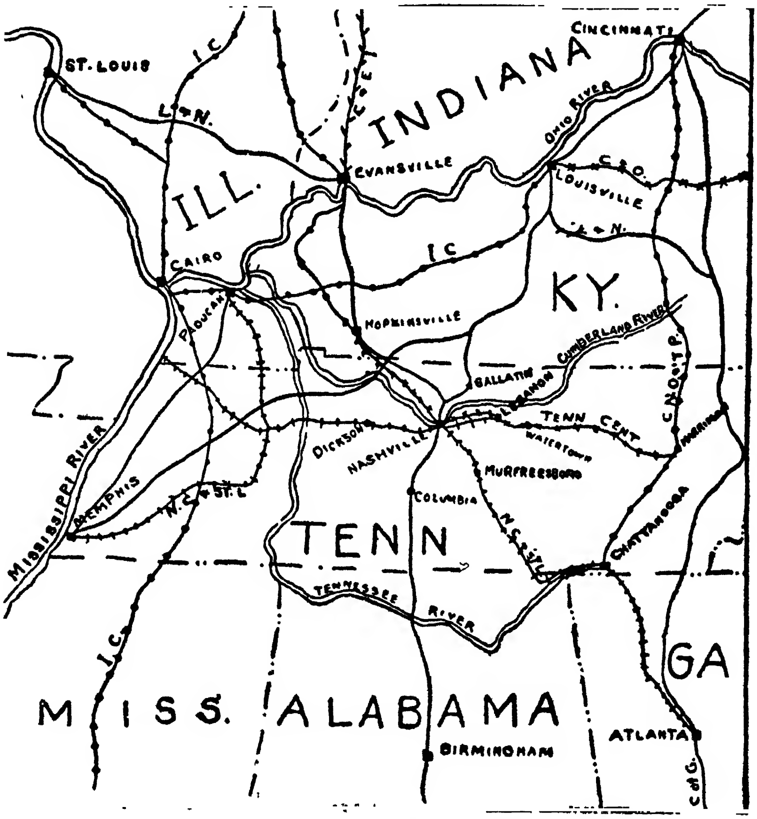


Plate 15.—Tennessee Railroad Net.

Mo., Memphis, Tenn., and other lower Mississippi River crossings, and points beyond in western trunk line territory and points in the states of Texas, Oklahoma, and Arkansas; and Ohio River crossings, Cairo, Ill., to Cincinnati, Ohio, inclusive, and points beyond in central freight association and western trunk line territories.

Unless otherwise noted, rates throughout this report will be

stated in cents per 100 pounds. The table below shows the first-class rates in effect on June 24, 1918, which illustrate the rate situation, and distances from representative points of origin to Nashville and the complaining points. Under General Order No. 28 of the Director General these rates were increased 25 per cent, effective June 25, 1918.

From—	To Nashville		To Murfreesboro		To Columbia		To Dickson		To Gallatin		To Lebanon		To Watertown	
	Miles	Rate	Miles	Rate	Miles	Rate	Miles	Rate	Miles	Rate	Miles	Rate	Miles	Rate
New York, N. Y.	954	100	966	125	1,000	125	996	136	946	126	923	118	909	125
Norfolk, Va	755	92	769	117	861	117	797	128	782	113	724	110	710	117
Savannah, Ga	548	93	516	118	552	118	590	129	575	119	579	118	593	129
Atlanta, Ga	288	72	256	72	292	83	330	93	315	93	319	90	333	97
Birmingham, Ala.	208	63	240	84	162	70	250	84	235	84	239	84	253	99
New Orleans, La.	608	90	640	115	577	108	566	119	635	113	639	115	653	126
Memphis, Tenn.	238	59	270	83	264	78	197	65	265	70	269	84	283	95
St Louis, Mo.	323	70	355	95	369	95	365	85	350	96	354	95	368	106
Chicago, Ill	447	98	479	107	493	107	441	102	452	108	478	100	492	134
Cairo, Ill	209	47	241	72	255	72	167	57	236	63	240	72	254	83
Paducah, Ky.	181	47	213	72	227	72	139	53	208	63	212	72	226	83
Evansville, Ind	157	47	189	72	203	72	193	79	163	63	188	72	202	83
Louisville, Ky	186	47	218	72	232	72	221	80	159	55	217	72	231	83
Cincinnati, Ohio	300	62	332	87	346	87	335	88	273	78	331	87	345	98

The first-class rates in effect on June 24, 1918, from Nashville to the complaining points were as follows: Murfreesboro, 25 cents; Columbia, 25 cents; Dickson, 36 cents; Gallatin, 26 cents; Lebanon, 25 cents; and to Watertown, 36 cents. These rates also were increased under General Order No. 28. The through rates to the complaining points are generally based on the Nashville combination. The exceptions to this rule are usually due to the fact that the complaining points are intermediate to Nashville, in some instances, particularly as to Murfreesboro, Columbia, and Gallatin, and the application of the mileage scales results in lower rates than the combination on Nashville. In many instances the rates to Dickson are less than the combination on Nashville for the reason that the rates from points north of the Ohio and Missouri rivers are based upon Paducah.

Some of the rates under attack were increased on January 1, 1916, in connection with the revision of rates following our report in *Fourth Section Violations in the Southeast,* 30 I. C. C., 153, 313. In certain instances the rates to some of the intermediate points, particularly Gallatin, were not changed at the time the rates to Nashville were increased. The rates to points beyond Nashville were generally increased to the same extent as those to Nashville.

In this readjustment the southern classification was made applicable in connection with the rates from eastern and interior eastern cities in lieu of the official classification, which also resulted in increased charges in some cases. . . .

The principal justification offered by the carriers for the maintenance of lower rates to Nashville than to intermediate points is that the rates are depressed by competition between the rail lines serving that point and by competition, actual or potential, with the boat lines operating on the Cumberland, Ohio, and Mississippi rivers.

It is asserted that the rail carriers serving Nashville are in active competition with each other for traffic to that point, which competition influences the rates; and that this situation does not exist at the complaining points. The record shows that the Tennessee Central is not a factor in making rates to Nashville, having met the rates in effect when it commenced operation in 1902, and since that time it has exercised little, if any, influence on the rates because of its light traffic, operating disadvantages, and financial condition. The Nashville, Chattanooga & St. Louis is controlled through stock ownership by the Louisville & Nashville. In *Financial Relations, etc., L. & N. R. R. Co.*, 33 I. C. C., 168, we found that the official record of these carriers clearly established that the purpose of control of the former by the latter was primarily to restrict competition and to maintain rates. We therefore find that the competition between the rail carriers serving Nashville is not of such a nature as to affect the measure of the rates to that point, and in determining whether the rates to Nashville are depressed we must consider the competition with the river lines only.

A very comprehensive record has been presented upon the question of Cumberland River competition and its effect upon rates to Nashville. The Louisville & Nashville commenced operation from Louisville to Nashville in November, 1859. In 1857, 33 steamboats were engaged in transporting freight between Ohio and Mississippi river cities and Nashville, of which 6 were through boats operated from Pittsburgh, 7 from Cincinnati, 3 from Louisville, 2 from St. Louis, 4 from Memphis, 5 from New Orleans, and 6 from Paducah. In 1870, 15 steamboats transported freight to Nashville, 4 of which operated from Cairo, 3 from Cincinnati, 4 from Pittsburgh, and 1 from Evansville, and the points from which the remaining 3 boats operated were not shown. At the

time of hearing, in March, 1917, 1 boat of 300-tons capacity operated weekly from Paducah to Nashville. At the same time there was a daily boat service from Cincinnati to Louisville, service twice a week from Louisville to Evansville, a somewhat irregular service from Evansville to Paducah, daily service from Cairo to Paducah, service twice a week from St. Louis and Memphis to Cairo, and regular boat and barge service between St. Louis and New Orleans, with stop at Cairo.

The following table shows the class rates published by the Louisville & Nashville from Louisville to Nashville from 1865 to and including January 1, 1916:

Date	1	2	3	4	5	6	A	B	C	D
Dec. 31, 1865	75	65	50	..	..	..	..	..	..	..
Aug. 1, 1869	70	60	45	35	..	..	..	..	..	..
July 1, 1872	55	45	42	30	..	..	..	..	..	..
Apr. 1, 1876	40	35	30	15	12	..	..	15	12	12
Aug. 12, 1878 [1]	..	..	..	..	..	..	..	..	..	..
Nov. 4, 1878	25	20	17	14	13	..	..	17	13	13
Dec. 3, 1879	35	28	24	19	15	15	15	19	15	15
Apr. 26, 1882	38	33	28	23	18	18	15	19	15	15
June 1, 1882	38	33	28	23	15	15	15	19	13	12
July 17, 1882	38	33	28	23	15	15	15	19	13	10
June 25, 1883	38	33	28	23	18	15	15	19	13	10
Mar. 15, 1886	38	33	28	23	18	15	15	19	11	10
Apr. 16, 1891	38	33	28	23	18	15	15	15	11	10
Aug. 1, 1908	38	33	28	23	18	15	15	18	11	10
Jan. 1, 1916	47	38	31	28	22	20	15	20	11	10

Specific instances are given by defendants of shipments of particular articles from competitive points to Nashville via the river lines. It is stated that the information in the possession of the defendants with respect to such shipments is not complete, and that recently the defendants have not attempted to check the movement of traffic via the river lines. The record shows conclusively that for many years after the Louisville & Nashville commenced operation to Nashville the competition with the river lines was very keen, and the witnesses testified at great length as to the various steps taken by the Louisville & Nashville to meet this competition. As hereinbefore shown, the first-class rate from Louisville to Nashville was reduced from 75 cents in 1865 to 20 cents in 1878 since which time the rate was gradually increased to 38 cents in 1882 and to 47 cents in 1916.

[1] A first-class rate of 20 cents was established on this date, but the rates for the lower classes were not given.

Complainants admit that the competition with the river lines influenced the rates to Nashville for some time, but contend that the question before us for determination is whether the present rates are affected by this competition. . . .

Complainants call attention to the fact that defendants refer specifically to but few shipments from competitive points to Nashville via the river lines since 1900. The defendants refer to 74 shipments of manufactured articles in 1901, 1905, and 1907 to 1913, inclusive, from competitive points to Nashville, and to shipments of grain in 1905 and 1915. Many of these shipments covered small quantities of freight. During 1911 and 1912 there was a considerable movement of merchandise and other manufactured articles which originated at various northern and eastern points. Complainants assert that this movement was artificially stimulated, as at that time the case of *Atlanta Freight Bureau* v. *N., C. & St. L. Ry.*, 29 I. C. C., 476, in which the Nashville Traffic Bureau intervened, was before us. Complainants' assertion seems to be borne out by the fact that, as shown by the annual reports of the chief of engineers, United States army, hereinafter referred to, the movement of merchandise and manufactured articles via the river lines greatly decreased.

The following table is taken from the annual report of the chief of engineers, United States army, for the year 1916, and shows the tonnage transported via the Cumberland River below Nashville for the calendar years 1906 to 1915, inclusive:

Year	Total tonnage	Farm products	Forest products	Merchandise, including flour and meal	Fertilizer	Sand and gravel	Miscellaneous, including coal, cement iron, machinery, etc.	Rafted products
1906...	223,899	29,185	159,346	2,000	.....	31,680	.....	1,688
1907...	300,810	40,928	227,189	20,600	1,500	1,800	2,850	5,943
1908...	259,734	24,176	217,272	6,300	.....	8,520	1,778	1,688
1909...	193,118	27,202	129,468	18,113	82	16,414	177	1,662
1910...	327,757	56,365	168,909	42,513	.....	45,000	9,770	5,200
1911...	223,278	23,264	145,334	7,159	700	40,916	2,305	3,600
1912...	176,659	21,431	59,373	10,800	.....	26,780	1,542	56,733
1913...	165,123	16,123	131,024	3,705	1,100	11,250	1,026	895
1914...	153,458	6,151	99,266	4,140	851	38,976	1,337	2,737
1915...	126,949	10,250	92,723	3,904	421	15,237	1,781	2,633

Of the traffic handled in the last year shown in the above table, 85,651 tons consisted of railroad ties, 9,707 tons of forest products other than railroad ties, 15,237 tons of sand and gravel. No figures are given showing separately the tonnage transported to or from local points and that transported to or from points also served by rail lines. . . .

Improvements in the form of a series of locks and dams have been made in recent years in the Cumberland River channel, and prior to the hearing in 1917 the river below Nashville was navigable for boats drawing 6 feet or less from 8 to 10 months during the year. Further improvements of the same nature were then under way, and when completed the river will be navigable for boats drawing 6 feet or less during the entire year between its junction with the Ohio and Nashville. . .

Before we can properly authorize the defendants to maintain lower rates to Nashville than to intermediate points it must be clearly shown that the circumstances and conditions surrounding transportation to Nashville are substantially dissimilar to those surrounding transportation to intermediate points. The testimony relied upon by defendants to support their allegation that the lower Nashville rates are necessary because of active and compelling competition with the river lines is not convincing. As stated above, defendants refer to some shipments of grain and manufactured articles from competitive points to Nashville via the river lines since 1900, but these shipments are comparatively few in number, and there is nothing in the record to indicate that this route is used regularly for the transportation of freight from competitive points in appreciable quantities. The competition with the river lines is almost entirely potential, and we are of the opinion that the competition disclosed by the record does not justify fourth section relief sought.

At the present time through rates to points beyond Nashville are generally made up of the rates to and from Nashville, so that Nashville merchants are usually enabled to compete for business at the complaining points on the same basis from a transportation standpoint as merchants located there, and when complainants undertake to compete with Nashville merchants at other competitive points they are at a serious disadvantage, as the combinations on the complaining points greatly exceed the combinations on Nashville. The defendants contend that the rates to Nashville are depressed by competition with the river lines, and that there-

fore the present basis of constructing through rates to points beyond Nashville is proper. We have already found that there is no compelling competition which justifies lower rates to Nashville than to intermediate points. Therefore in using the combination in constructing through rates to points beyond Nashville the defendants are applying the basing-point system, which has been repeatedly condemned by us. It appears from the record that it has been the purpose of defendants to maintain rates to Nashville which will enable that point to compete with other large commercial centers in the same general territory. The defendants can not lawfully extend such a basis of rates to Nashville, and at the same time ignore the rates to other points in the immediate vicinity.

Upon the facts of record we are of the opinion and find that the rates attacked have not been shown to be unreasonable, and that the defendants have justified the rates which have been increased since 1910; that the competition with the boat lines operating on the Cumberland, Ohio, and Mississippi rivers encountered by defendants in transporting freight to Nashville is not of such a character as to control or to affect materially the rail rates to Nashville, and the applications for authority to continue lower rates to Nashville than to intermediate points should be denied; that the present rates to the complaining points to which traffic moves through Nashville subjects such points to undue prejudice and unduly prefers Nashville to the extent that the through rates exceed the rates contemporaneously maintained to Nashville plus 75 per cent of the local rates contemporaneously maintained from Nashville to the complaining points.

The establishment of the percentage relation is not to be held as an approval by us of the existing local rates from Nashville to the complaining points as being reasonable to apply as factors of through rates even on the basis proposed. The complainants have established their right to relief from the undue prejudice. The relief granted is considered on the average, and in the absence of sufficient evidence to enable us to prescribe just and reasonable through rates in each instance.

There is no showing that complainants have been damaged because of the unlawful rate adjustment, and reparation is therefore denied.

Appropriate orders will be entered.

B. REPORT OF THE COMMISSION ON FURTHER HEARING [1]

McChord, *Chairman:*

In the original report herein, 55 I. C. C., 648, we considered certain fourth-section applications, heard in connection with the complaint, in which authority was sought to continue to maintain class and commodity rates from numerous points of origin to Nashville, Tenn., lower than the rates contemporaneously maintained on like traffic to intermediate points. Among the applications were portions of No. 3912, filed by the Tennessee Central Railroad. We found that the competition between rail carriers and with river lines serving Nashville was not such as to affect materially the rail rates to Nashville and we denied the applications for relief from the provisions of the fourth section. . . .

Upon representation by the Tennessee Central that because of its financial condition compliance with the fourth-section order would result disastrously to it, the portion of that order which applied to the Tennessee Central was vacated and set aside. . . .

The only objection to granting the relief sought was interposed on behalf of the Traffic Bureau of Knoxville, Tenn., upon the grounds that the rates on intrastate traffic from Knoxville to Nashville are abnormally high, and that if these rates were applied to stations intermediate to Nashville the applicant would not suffer any reduction in revenue; and, further, that the intrastate rates from Knoxville to intermediate stations on the Tennessee Central are unduly prejudicial to Knoxville and unduly preferential of Chattanooga, Tenn. It was accordingly requested that the application be denied with respect to rates from Knoxville. The points of origin included in the portions of the application here concerned do not include Knoxville or Chattanooga. Moreover, the rates in which the Traffic Bureau of Knoxville is interested are intrastate rates, and since no undue prejudice to or unjust discrimination against interstate commerce is alleged, those rates are without our jurisdiction.

For several years prior to December 8, 1919, the Tennessee Central had authority from us to charge class and commodity rates applicable on interstate traffic from Ohio and Mississippi River crossings, southeastern and Carolina territories, Gulf and south Atlantic ports, eastern and Virginia cities, and points related thereto, to junction points reached by that carrier, including

[1] 73 I. C. C. 228 (July 26, 1922).

Nashville, the same as the rates contemporaneously in effect on like traffic from the same points of origin to the same destinations via other lines, and to charge higher rates to intermediate points on the Tennessee Central, provided the rates to the intermediate points did not exceed the lowest combination.

The Tennessee Central was constructed in 1902. It extends from Hopkinsville, Ky., in an easterly direction through Nashville to Harriman, Tenn., a distance of 261 miles, with branch lines diverging from the main stem. It connects with the Illinois Central at Hopkinsville; with the Louisville & Nashville at Hopkinsville, Nashville, and Clarksville, Tenn.; with the Nashville, Chattanooga & St. Louis at Nashville and Lebanon, Tenn.; with the Cincinnati, New Orleans & Texas Pacific at Emory Gap, Tenn.; and with the Southern at Harriman. Applicant alleges, and we found in our original report, that it is not a factor in making rates to Nashville, having met the rates in effect when it commenced operation, and since that time it has exercised little, if any, influence on the rates because of its light traffic, operating disadvantages, and financial condition.

The territory through which applicant operates is sparsely populated and furnishes only a small amount of traffic. Nashville, with a population of 118,342, is the only city of importance on its line. The topography of the country served by applicant is extremely mountainous. A train starting at Hopkinsville or Harriman for Nashville encounters many bridges, heavy grades, and sharp curves. Between Buffalo Valley, Tenn., and Silver Point, Tenn., there is a 3.5 per cent grade and an ascent of 513 feet within a distance of 5 miles. Between Nashville and Buffalo Valley, about 70 miles, there are 32 ascending grades eastbound, with a maximum grade of 2.3 per cent and a maximum curvature of 10°, the miles of curved line representing 31.8 per cent of the total distance. The line eastbound from Hopkinsville to Nashville, 83 miles, has 35 ascending grades, with a maximum grade of 1.6 per cent. Of the distance 29.8 per cent is curved with a maximum curvature of 10°. On the line east of Nashville the drawing capacity of its heaviest engine is limited to from 275 to 700 tons; west of Nashville the same engine will draw 1,000 tons under normal conditions, provided it has a helper out of Nashville to Pittsfield, Tenn.

A comparison of operating statistics of applicant and its competitors shows that the average number of loaded freight cars per

train-mile on the Tennessee Central for the calendar year 1917 was 10.76, while the average for its competitors ranged from 17.72 for the Louisville & Nashville to 26.32 for the Illinois Central. The number of tons carried one mile per mile of line in 1917 was over 25 per cent less than that of any of its competitors during the same year.

The operating conditions referred to and the low density of tonnage have resulted in very high operating costs for the Tennessee Central. It is shown that the ratio of operating expenses to operating revenues has steadily increased since 1912, ranging from 78.67 per cent in that year to 103.92 per cent in 1920. In 1919 and in 1920 the road had a deficit from railway operations of $336,-928.82 and $114,706.88, respectively. A comparative statement of the income of the road, after deductions for taxes, uncollectible railway revenue, interest on funded and unfunded debt, hire of equipment, joint-facility rents, rent for leased roads, and other miscellaneous items, shows that applicant has suffered a deficit for every year since 1912, when it was placed in the hands of receivers. The net railway operating revenue per mile of line for the calendar year 1917 is shown as $1,422, as compared with from $2,947 to $12,485 for its competitors. It was testified that if the Tennessee Central observed literally the long-and-short-haul clause of the fourth section to all intermediate points on its line on all classes and commodities, its very existence would be threatened. An exhibit was presented to show that if the rates to Nashville and divisions thereof accruing to the Tennessee Central had been applied on all traffic to its local stations for the month of March, 1920, which is stated to be a representative period, it would have resulted in a reduction of its revenue for that month of $5,839.67, or 49 per cent.

The rates to local points on the Tennessee Central east of Nashville are made on combination to and from the junction points, and the rates to local points west of Nashville are based on the Nashville, Hopkinsville, or Clarksville combination, whichever is lower. Numerous exhibits were presented to show that the rates from representative points of origin to intermediate points on the Tennessee Central higher than the rates to Nashville compare favorably with the rates on other and stronger lines, including its competitors, for similar distances.

We are of the opinion and find that (1) the rates in effect from the territories of origin described to Nashville are not within the

control of the Tennessee Central; (2) the statements of the operating expenses and earnings of the Tennessee Central, as shown by its reports to us, indicate that it has had great difficulty in meeting its actual operating expenses out of operating revenues; (3) the persons and communities served by the Tennessee Central are interested in its maintenance as a channel of commerce, and the reductions in its rates which would be brought about through a strict compliance with the fourth section would be unwarranted at this time in view of its small volume of traffic and difficult operating conditions; (4) the relief under the fourth section asked for should be granted upon condition that the rates to the intermediate points on the Tennessee Central shall not exceed the lowest combination.

An appropriate order will be entered.

Hall, *Commissioner*, dissenting in part:

I concur in the finding that relief from the fourth section should be granted, but the reason therefor should be the Tennessee Central's disadvantage in meeting rail-carrier competition at Nashville because of its high operating costs resulting from difficult operating conditions. Its position in this respect is analogous to that of a carrier whose costs are high because of circuitous hauls. I can not concur in the majority's findings to the extent that they rest upon the Tennessee Central's weak financial condition. Following that principle we could deny relief to another carrier similarly situated because it is financially strong. Varying degrees of prosperity or adversity can hardly constitute the "special cases" of which the fourth section speaks.

Commissioner Campbell dissents.

2. Transcontinental Rates [1]

By the Commission:

These proceedings comprise fourth-section applications of the transcontinental lines proposing to establish from and to the Pacific coast terminals lower rates than are in effect to and from intermediate points on traffic having origin or destination in the so-called defined territories lying, roughly speaking, east of the Rocky Mountains. The Pacific coast terminals in question are ports of call in California, Oregon, Washington, and British

[1] *Transcontinental Cases of 1922*, 74 I. C. C. 48 (October 30, 1922). See Jones, pp. 166–182, and Vanderblue and Burgess, pp. 201–3.

Columbia for steamships plying between those ports, on the one hand, and Atlantic and Gulf ports, on the other, through the Panama Canal. The intermediate territory, hereinafter referred to as intermountain territory, embraces such typical points as Spokane, Wash.; Reno, Nev.; Salt Lake City, Utah, and Phœnix, Ariz. On many commodities the intermediate territory extends east of Helena, Mont., Denver, Colo., Albuquerque, N. Mex., and El Paso, Tex.

The proposed reduced rates are grounded on the low rates by steamship lines between the Atlantic and Gulf ports and the Pacific ports, and the movement of a substantial volume of traffic thereunder.

Except as otherwise noted, the rates of the applicant carriers are the same over all routes, and apply not only all rail, but, so far as New York City is concerned, also in connection with the Southern Pacific Company's steamship line operating between that point and New Orleans, La., and Galveston, Tex. For convenience, the rates of the applicant carriers will be referred to as the rail rates and the applicants as the rail lines. The steamship companies will be referred to as the water lines, and their rates or those applying in connection therewith, plus the incidental charges hereinafter explained, will be referred to as the water charges. All rates and charges are stated in cents per 100 pounds, except as otherwise noted. They do not include the general reductions of 1922.

THE GENERAL WESTBOUND APPLICATION

Fourth Section Application No. 12063

This application proposes the establishment of reduced rates to the Pacific coast terminals on various commodities from all points in the defined territories.

Applications covering this same general traffic have been made at various times in the past, and the maintenance of lower rates to the terminals than to intermediate points was generally permitted until March 15, 1918. . . . On the above date all departures from the long-and-short-haul rule in westbound transcontinental rates were removed under the decisions in *Reopening Fourth Section Applications*, 40 I. C. C., 35, and *Transcontinental Rates*, 46 I. C. C., 236. It was there found that due to the withdrawal of ships for use in the trans-Atlantic service water competition between the Atlantic and Pacific ports was no longer a compelling

force; and we found that the maintenance of lower rates to the coast than to intermediate points unduly preferred the coast. We denied relief from the long-and-short-haul rule, and expressed the view that the commodity rates in certain instances at least might be graded, as the class rates had been; that is, made lower to the intermediate points than to the terminals. The rates on certain high grade traffic, including such articles as pianos and rubber tires, were graded; but, generally speaking, the rates to the terminals were increased to the extent necessary to put the terminals on a parity with the intermediate points, resulting in a blanket extending several hundred miles inland from the Pacific coast. This adjustment was approved in *Transcontinental Commodity Rates*, 48 I. C. C., 79. It was subjected to the general increases of 1918 and 1920, and the general reduction of 1922, but otherwise has remained substantially unchanged up to this time.

The failure of the carriers to grade more of their rates brought forth a complaint from intermountain territory which alleged that the rates to these points were unreasonable and unduly prejudicial as compared with the rates to the terminals. We found that the rates, in general, were not unreasonable or unduly prejudicial and dismissed the complaint. *Intermediate Rate Asso.* v. *Director General*, 61 I. C. C., 226, March 29, 1921. We held that there was some water competition and expressed the view that strong water competition was likely to be resumed within a short time.

A few months later, in August, 1921, this application was filed. Hearings were had at various points throughout the country during November, December, and January following. The record shows that for some time previous to the hearings traffic destined to the Pacific coast had been moving by water in heavy volume. Competition was keener and the water service more efficient than at any time before the war. The rail lines and the water lines, respectively, upon request furnished statements of the tonnage moved from the defined territories to the Pacific coast during June, July, and August, 1921. These statements show that considerably more than half the traffic in most all of the commodities involved was shipped by water. As to some commodities the movement was nearly all by water. All but a small portion of the water-borne traffic originated in and east of Buffalo-Pittsburgh territory, indicating that the Pacific coast interests are making their purchases in that part of the East which is trib-

utary to the water lines and from which they can secure low rates. The movement by water may be relatively greater now than it was during the period of the hearings, for the water service was then only beginning to develop on a large scale.

The following were the principal steamship lines then operating in this intercoastal service:

	Sailings	Ships
Williams Steamship Company	Every 21 days	5
Pacific Mail Steamship Company	" 21 "	3
Luckenbach Steamship Company, Incorporated	" 7 "	15
United American Lines, Incorporated	" 7 "	16
Atlantic, Gulf & Pacific Steamship Corporation	" 15 "	6
North Atlantic & Western Steamship Company	" 15 "	6
Matson Navigation Company	" 35 "	2
Isthmian Line (operated by the United States Steel Products Company, a subsidiary of the United States Steel Corporation)	Every 12 days	11
Elder Steele Steamship Company	" 45 "	2
Robert Dollar Line	" 60 "	1
Pacific Caribbean Gulf Line	" 21 "	5
Congress Line	" 25 "	1
Intercoastal Sea Carriers	" 30 "	4

These lines operated in this service over 75 steamships, and the number of steamships was increasing. Most of them plied from the north Atlantic ports. Several of the stronger lines maintained regular sailing schedules, the ships departing whether fully loaded or not. Sailings from the north Atlantic ports were at least three or four per week. Two of the lines, the Luckenbach and the Pacific Caribbean Gulf Line, maintained service from the Gulf ports. They had a total of about a dozen ships in this latter service. The sailings were not as regular as from the north Atlantic ports, the ships staying in port until they obtained full cargoes. Sailings averaged about three per month.

Most of the ships were of first-class construction, modern in every respect, and afforded efficient service. Many of them were designed especially for handling coast-to-coast business. The sailing time of the best ships between New York and San Francisco, Calif., ranged from about 18 to 21 days. However, from and to the northern ports, for instance, from Boston, Mass., to Vancouver, British Columbia, the sailing time was longer, as stops of several days were made at other ports en route.

Comparatively little of this water-borne traffic originated at the ports. It generally moved via the north Atlantic ports. The small portion which moved from points west of the Buffalo-Pittsburgh district went either to the north Atlantic ports or to the

Gulf ports for transshipment. The traffic via the Gulf was not heavy. The Gulf lines depended mainly on iron and steel from the Birmingham, Ala., district and on commodities produced near the Gulf, such as rosin and turpentine. They drew comparatively little traffic from the North and Middle West. Some of that traffic moved by rail to St. Louis, Mo., or Cairo, Ill., and thence by the barges of the Mississippi-Warrior Service, operated by the War Department, to New Orleans. This line operated excellent steel barges, and, on the southbound movement particularly, drifting with the current, made fairly good time, averaging about nine days to New Orleans. Sailings from Cairo, the winter port, were at the rate of about two per week, each consisting of a fleet of six barges. This line is used mainly for heavy commodities. Its traffic destined to the Pacific coast has been rather light. During the 15 months' period from October, 1920, to December, 1921, inclusive, there were only about 100 carloads, principally canned goods, starch, and iron and steel from Illinois points and St. Louis.

At the time the application was filed all traffic from interior points that was shipped by the water lines was charged local rates to the ports. Effective February 15, 1922, the lines from Chicago, Ill., and related points, principally in Illinois, proposed proportional rates to the Gulf ports for application on traffic destined to the Pacific coast through the Panama Canal, equal to the local rates from Chicago to New York City. The obvious purpose was to put the Gulf ports on a rate parity with the north Atlantic ports as to traffic to the Pacific coast. These rates were originally suspended by us, but were permitted to become effective April 1, 1922. The Mississippi-Warrior Service maintains lower rates than the all-rail lines to the Gulf, the differential from all points being 20 per cent of the St. Louis-New Orleans rail rate. This line also publishes joint through all-water rates from St. Louis and Memphis, Tenn., to the Pacific coast via New Orleans and the steamship lines. Rates from Chicago and points in the Middle West over this route generally are made on the basis of rail rates to St. Louis and the water charges beyond, or on the basis of the proportionals to New Orleans plus the water charges beyond.

Practically all of the important water lines were at the time of the hearings members of a conference and under a "gentlemen's agreement" to maintain what were known as the conference rates. These rates were on file with the United States Shipping Board,

but the water lines were not under any legal requirements to adhere to them. There is considerable evidence to the effect that, particularly on iron and steel, which is desirable traffic, the conference rates have been cut in a very substantial way. In many instances these special rates no doubt represent, or were the result of, contracts between water lines and shippers for heavy movements. Apparently the stronger lines with first-class service are more likely to adhere to the conference rates than the weaker lines with less frequent sailings and slower schedules. It was stated for the principal conference lines at the argument in June, 1922, that they were then observing the conference rates, except that contract rates previously made were being accorded. At the close of the hearing the first seven lines above named were members of the conference, but it was understood that the eighth, namely, the Isthmian Line, was observing the conference rates, at least on iron and steel. . . .

The commodities here considered are not the only ones as to which there is substantial competition with the water lines. It was the declared purpose of the carriers to be conservative, and not to meet water competition except where it is a matter of serious concern, and then only within reasonable limits. If the competition further develops, the rail lines plan from time to time to seek relief on additional commodities. The present application covers only carload traffic, but later applications may be filed to include some that is less than carload. It was said that if the steamship lines reduce their rates, as in fact they have since done, the rail carriers may seek authority to meet the situation thus created.

None of the proposed rates meet even approximately the coast-to-coast rates of the water lines. They are not generally intended or expected to draw or to hold any large amount of the port-to-port traffic to the rail lines. They did, however, at the time of the hearing, approximate the charges available from certain interior points to the Pacific coast terminals by rail to the Atlantic and Gulf ports and thence by water, plus such incidental charges as marine insurance and unloading and transfer charges at Pacific coast terminals.

In determining the rate to be applied on each commodity the carriers generally selected the interior point or points at which the competitive traffic originates in largest volume, and from which the local rate to the Atlantic seaboard was, in their opinion,

high enough when taken in connection with the port-to-port water rate and incidental charges, to constitute the basis for arriving at a reasonably compensatory all-rail rate. For instance, the rate proposed from all points on iron and steel approximated the rate from Pittsburgh, Pa., to the Pacific coast via Baltimore, Md., rail and water, plus a few cents to represent the superiority of the rail service. It was not intended to meet the competitive situation at the north Atlantic ports, as the port-to-port water rate was so low as to make that impossible. In determining the rate on each of the commodities considered there were added generally a few cents to the basic figure. The rate arrived at, according to the above method, was, as a rule, proposed from all points in the defined territories to the Pacific coast terminals. It was blanketed to apply from all points east of the rate-fixing point in order to accommodate those who, for some special or emergency reason, preferred to pay a substantially higher all-rail rate than is available in connection with the water lines. It was blanketed to apply from points west of the rate-fixing point in order to keep all parties in position to do business in competition with those who could use the water routes to advantage. Ordinarily a given commodity is produced at many points in the defined territories, and a buyer on the Pacific coast is not likely to purchase in the Middle West if he can get the same article in the East at about the same price and at a much lower freight rate. The blanketing of points of origin, it was hoped, would induce the movement of traffic from the Middle West and afford the carriers the same kind of traffic, with the same gross revenues for the shorter haul, as they would receive for the longer haul from the points farther east. In other words, the lines west of Chicago would rather move traffic from Chicago than from Pittsburgh, for they would thus avoid a division of the rate with their eastern connections. If they should publish a higher rate from Chicago than from Pittsburgh because the rail-and-ocean rate from Chicago was higher than from Pittsburgh, not much of the traffic would originate at Chicago. The eastern points would presumably do the lion's share of the business, shipping either by the water lines or all rail, the former route depriving the western lines of the traffic, and the latter necessitating several hundred miles more of rail haul than if the traffic moves all-rail from Chicago. In a few instances it is attempted to justify this blanketing arrangement by the fact that traffic can be shipped from Chicago, Birmingham, Ala., and the Middle West in general,

via the Gulf ports, at through rates to the Pacific coast that approximate the rates via Atlantic ports from producing points farther east, such as Pittsburgh and Cincinnati, Ohio. Keeping the Middle West on a rate parity with the East is alleged to be wholesome in its economic effects, in that it tends to distribute manufacturing industry and avoid its concentration in the East. Stated otherwise, it tends to prevent the exclusive development of the country within range of the seaboard to the disadvantage of the interior. The lines west of Chicago might be inclined to provide lower rates from the Middle West than from seaboard territory, in order to develop points of origin on their own lines, but they might thus lose traffic from points east. Moreover, it seems to be the policy of the Southern Pacific Company, with its steamship line reaching New York City, to keep that point on a parity with the Middle West. This has tended to blanket points of origin. It may be noted that subsequent to the hearings the Southern Pacific published on a number of commodities reduced rates from its New York piers to Pacific coast terminals, which conform to the long-and-short-haul rule. They are now under suspension in Investigation and Suspension Docket No. 1511, *Reduced Rates from New York Piers.*[1] Five of these commodities, namely, canned goods, linoleum, coffee, paints, and cordage, are included in this application, which asks authority to establish over all routes still lower rates to the terminals only.

The carriers are not disposed to blanket their rates to points of destination, and therefore make application for relief from the long-and-short-haul rule. They state that to blanket the proposed rates to destinations might mean for them loss of net revenue greater than the profit that would be obtained from the proposed rates to the terminals. The rail lines contend that to points of destination there is not so much opportunity for shortening the haul as there is with reference to points of origin. The position of the carriers seems to be that Chicago and points in that part of the country can produce all the manufactured articles that the Pacific coast and intermountain territory consume, and that the movement from the Middle West as well as from the seaboard should be encouraged because it is in the interest of the carriers, while on the other hand the intermountain territory can not con-

[1] These rates were upheld. *Reduced Commodity Rates from New York Piers,* 89 I. C. C. 512.—Ed.

sume, or its jobbers reasonably or economically distribute, all the traffic that now goes to the Pacific coast. In other words, the carriers seemingly feel that comparatively little could be accomplished in the way of shortening the haul by affording interior points such as Spokane, Reno, and Phœnix the same rates as the coast, because the capacity of these points for consumption and distribution is limited. The territory tributary to them is rather sparsely settled. Apparently, the carriers' view is that it is not possible by freight rates materially to increase consumption at these points nor materially to develop them as distributing points; and that no such adjustment of rates will make Spokane, Reno, and Phœnix the distributing centers for the more densely populated territory along the Pacific coast.

While on traffic to the Pacific coast it is proposed to keep the Middle West on a parity with seaboard territory, the latter would be required to pay more than the Middle West on traffic to intermountain territory. In other words the present rates both to the terminals and to intermountain territory are graded as to territories of origin. For instance, the rates on structural steel to both regions of destination at the time of the hearing were \$1.175 from Colorado common points, \$1.255 from Missouri River, \$1.42 from Mississippi River, \$1.50 from Chicago, \$1.585 from Cincinnati, \$1.665 from Pittsburgh, and \$1.835 from the Atlantic seaboard. This grading arrangement would be left unchanged on traffic destined to intermountain territory, although on traffic destined to the terminals, as previously explained, it is proposed to blanket the rates over the whole territory of origin, affording the terminals a wider range of markets than afforded the intermediate points. The intermountain interests in order to draw traffic from the Atlantic seaboard must surmount an obstacle in the form of higher rates than from Chicago. To reduce the rates from the Middle West to the Pacific coast on account of the water rates from seaboard territory to the Pacific coast is in the interest of western rail lines, but a reduction from seaboard territory to intermountain territory to meet the existing rail rates from the Middle West to intermountain territory would lengthen the haul on such traffic as moved from the seaboard region and not benefit the western rail lines. In fact the applicants represent that if the rail lines should insist on hauling traffic from seaboard territory rather than from Chicago at an equality of rates they might lay themselves open to a charge of inefficient operation.

As to intermountain territory, there is, it is alleged, no compelling reason for such a policy of rate making.

In addition to the rail rates to the Atlantic and Gulf ports and the water rates beyond, there are incidental charges that must be taken into account in computing the water charges which the rail lines seek to meet. The water rates do not include marine insurance, the cost of which varies according to the value of the commodity shipped, and also according to the extent to which a shipper desires to insure his shipment. On canned goods, for instance, the insurance varies from about 2.5 cents to 4 cents per 100 pounds. On iron and steel it ranges from about 0.5 to 2 cents per 100 pounds. On paints it varies from about 2.5 to 5.5 cents per 100 pounds, and on twine and cordage from about 3 cents to 6 cents per 100 pounds. There is some difference between the rail lines and the water lines as to what the average insurance charge is on several of the articles involved. There are also wharfage charges at San Pedro, Calif., of 0.5 cent and at Portland, Oreg., and Seattle, Wash., of 1.5 cents per 100 pounds. At San Francisco there is a State toll of 0.75 cent per 100 pounds. The cost of unloading is generally 3 cents per 100 pounds at all the Pacific ports. Since the water rates do not include the cost of switching from the wharf to the consignee's siding or other place of final delivery, the usual local switching charges must be added, which range generally from $3 per car upward. Owing to the difference in the various charges above referred to it is impossible to state the rates via the water lines with exactness. It is not necessary to be exact, however, as the rail lines are not proposing to meet any particular rate, but rather the general rate situation created by the water lines.

It is of course not necessary to have the same rate by water as by rail to afford the two sets of carriers equality of opportunity from any given point of shipment. The slower service, the necessity for making arrangements for transshipment at the ports, the irregularity of ship movements, special requirements as to marking, and other considerations operate to the disadvantage of the water lines. Due to the transfers at the ports, difficulties incident to stowage of mixed cargoes, the rolling of the ships, atmospheric conditions, and changes in temperature while en route, the shipment of goods by water often damages them more than shipment by rail in carloads. Many of the same disadvantages are experienced in shipping by water in carloads as when the

goods are shipped in less than carloads by rail. For instance, fancy labels on boxes of canned goods may become scratched and soiled, the boxes broken, and the cans bent. Sheet iron has often been crumpled at the edges, plates dented, and bars bent. Kegs of horseshoes have become broken and the contents mixed. Some articles are easily rusted by sweating in the ship's hold. Linoleum may become chafed by contact with other articles. Steam radiators have been cracked. Damages of the kind above referred to may not always be such as to warrant the filing of a claim, but they often entail some expense or a shading of prices, affect the salability of the article, and generally annoy the trade. On perhaps most of the commodities considered shippers as a rule prefer rail to water movement unless there is a differential of from 10 to 25 cents per 100 pounds, dependent upon the commodity, in favor of the latter. A few articles, like iron and steel, require nearly as low a rate by rail as by water. . . .

THE FOURTH SECTION AS AMENDED

Where water competition is involved, the applicants contend that they demonstrate the propriety of relief from the long-and-short-haul rule when they show that the competition by water is actual and compelling; that the rates proposed to meet the water competition, while less than they might otherwise be, are necessary if applicants are to secure an equitable share of the traffic; that the proposed rates yield some margin over the extra expense involved in taking on the additional traffic moving thereunder; and that the rates maintained to intermediate points are not unreasonable in themselves. . . . This showing, they aver, brings them squarely within the rules under which we administered the fourth section prior to the amendments of 1920. They further contend that the present wording of the fourth section, prohibiting us from granting relief where the charge to or from the more distant point is not reasonably compensatory for the service performed, does not in anywise invalidate the sufficiency of the showing which they here make. In short, they contend that if the proposed terminal rates are all they can get, and yield something in the way of net revenue, they are perforce reasonably compensatory.

This requirement of the amended fourth section that—

in exercising the authority conferred upon it in this proviso the Commission shall not permit the establishment of any charge to

or from the more distant point that is not reasonably compensatory for the service performed—

has proved to be the crux of the issue presented as to meaning of the amended fourth section.

For the intermountain interests it is argued that a rate to be reasonably compensatory to the more distant terminal point must bear its full share of operating expenses, interest on funded debt, equipment and joint facility rents, taxes, and the percentage return fixed by us pursuant to section 15a of the interstate commerce act. In support of this interpretation various court decisions are cited defining the words "reasonably compensatory," or words that are said to be tantamount thereto.

We are unable to accept this interpretation of the phrase "reasonably compensatory." So interpreted, the long-and-short-haul rule of the fourth section must become absolute or rigid from the very nature of the case. According to this version of "reasonably compensatory," the rate to the farther distant point must yield its full share of the expense of utilizing the additional track mileage covered, as well as its full share of the additional expenses incident to the longer use of equipment required for the longer haul. There may be difficulty in discovering to a nicety the exact legislative intent in the amended fourth section. But the rejection of an absolute long-and-short-haul clause by both Houses of Congress is inconsistent with any construction of the phrase in question which would be equivalent in effect to an absolute clause.

A similar but less extreme interpretation of the words "reasonably compensatory" is urged on behalf of various State commissions in the intermountain territory. It is pointed out that there is a margin between a rate which barely escapes being confiscatory and the highest rate which a regulating body may lawfully allow. To the intermediate point a rate might approach the latter limit while a rate to a more distant point might conceivably be less and yet not so low as to be confiscatory. Seemingly, the rate to the more distant point may contribute something less than a full proportionate share of return upon investment and thus theoretically be less than a greater rate to an intermediate point. This version of "reasonably compensatory" seems to agree with the former interpretation in that both require that the rate to the more distant point must pay its full share of all operating expenses, but is more elastic in not requiring that it must contribute its

full share to the return designated as profit. Both interpretations appear to hold in common that a "reasonably compensatory" rate can not be less than a rate which, if imposed by a regulatory tribunal, would be adjudged nonconfiscatory.

We are unable to accept this interpretation of the words "reasonably compensatory" as used in the amended fourth section.

Where a rate imposed by a regulatory body is under judicial review upon the allegation that the rate fixed is confiscatory, it has been held by the courts that a rate may not lawfully be fixed by such tribunal which is based alone on the out-of-pocket costs ascribable to that particular traffic, but that to be lawful the rate must be sufficient to cover a ratable proportion of the average cost of freight traffic generally, including a return on the property devoted to public service. To hold otherwise would compel the performance of a certain specified kind of service by the carrier at less than average cost. The extension of this principle to other classes of traffic, if pursued far enough, would bankrupt the road.

Where, however, carriers voluntarily propose to reduce certain rates to an out-of-pocket *plus* basis in order to augment the total traffic carried, a wholly different situation is presented. The menace of confiscation is absent . . . and the additional traffic, if secured with a resulting augmentation of net revenue instead of laying a burden upon other traffic, affords the possibility of lightening the burden thereon by bringing a greater tonnage under contribution to net revenue.

The criteria of a reasonably compensatory rate in a confiscation case are therefore essentially distinct from the criteria of a reasonably compensatory rate where carriers volunteer a reduction on certain rates to an out-of-pocket *plus* basis. In the first set of cases the carrier has presumably been charged with seeking to extract from the public which is served more than the services are reasonably worth; in the second set of cases the carrier is accused by protestants, not primarily of seeking to extort more than the service is reasonably worth to those who receive the service but of working undue discrimination as between those who can and those who can not avail themselves of the lower rates voluntarily proposed.

The criterion of a reasonably compensatory rate suggested by the carriers has been indicated above. It is summarized in the formula "out-of-pocket-expenses-plus-some-profit."

Just as we have rejected the two interpretations of "reasonably compensatory," suggested by the protestants as too narrow, so we are disposed to reject the single criterion suggested by the carriers in the above formula as insufficient, standing alone. It is probably true that this formula was deemed by us as adequate in disposing of fourth-section applications prior to the amendments of the fourth section in the transportation act, 1920, *Fourth Section Violations in the Southeast,* 30 I. C. C., 153. We do not agree with the carriers that the fourth section has not been changed in substance. The amendment has made mandatory what theretofore rested in our sound discretion as to compensation for the service performed to the more distant point, as to circuity, and as to potential water competition. Moreover, in section 500 of the transportation act, 1920, is expressly declared the policy of Congress to foster and preserve in full vigor both rail and water transportation. We think the amendment was the Congress's way of saying that we should follow a less liberal policy in dealing with departures from the long-and-short-haul rule than had been followed in former years. Our administrative power at this time is in some respects narrower than before the amendment. The fourth section, as amended, requires the observance by us of certain administrative rules which we were enforcing prior to the amendment, but which in some measure lay within our sound discretion to modify or change. We are also required now to accord due observance to section 500 of the transportation act, 1920, which indicates the purpose of Congress—

> to promote, encourage, and develop water transportation, service, and facilities in connection with the commerce of the United States, and to foster and preserve in full vigor both rail and water transportation.

Moreover, the requirements of section 15a may not be defeated or jeopardized by the action of particular rail carriers seeking to augment their own net earnings, irrespective of the effect of rate changes adverse to the carriers of the country generally, or of a large territorial group. *Trunk Line and Ex-Lake Iron Ore Rates,* 69 I. C. C., 589. It clearly would defeat the intent of Congress to foster transportation by rail and water in full vigor if the rail carriers were permitted, at practically little or no profit to themselves, to operate so as to deprive water carriers of traffic which the water carriers would naturally handle. Moreover, it must be borne in mind that where the out-of-pocket theory is used as

a rate basis, there is inevitably thrown upon the rest of the traffic the task of providing the bulk of the net return contemplated in section 15a. Too wide an extension of the out-of-pocket theory would transpose the entire burden of producing dividends and interest and meeting other fixed charges upon only a part of the traffic carried.

In the light of these and similar considerations, we are of opinion and find that in the administration of the fourth section the words "reasonably compensatory" imply that a rate properly so described must (1) cover and more than cover the extra or additional expenses incurred in handling the traffic to which it applies; (2) be no lower than necessary to meet existing competition; (3) not be so low as to threaten the extinction of legitimate competition by water carriers; and (4) not impose an undue burden on other traffic or jeopardize the appropriate return on the value of carrier property generally, as contemplated in section 15a of the act. It may be added that rates of this character ought, wherever possible, to bear some relation to the value of the commodity carried and the value of the service rendered in connection therewith. We also find that where carriers apply for relief from the long-and-short-haul-clause of the fourth section and propose the application of rates which they designate as "reasonably compensatory," they should affirmatively show that the rates proposed conform to the criteria indicated above. It goes without saying that carriers should not propose rates or rate structures for approval in a fourth-section application which create infractions of other provisions of the interstate commerce act, and particularly of section 3.

THE GENERAL WESTBOUND APPLICATION

Statistical data were offered by the carriers to prove that the proposed rates to the terminals would be sufficient to pay something over and above the out-of-pocket costs. . . .

There is another aspect of this general westbound application which requires careful scrutiny. This is the way in which the rate structure resulting from its approval would comport with other sections of the act, particularly section 3.

It is strongly contended that the resulting rate structure would unduly and unlawfully prejudice the Atlantic seaboard region, and would unduly and unlawfully prefer large sections of the central region from Pittsburgh to beyond the Missouri River, in

respect of their traffic to the intermountain country and to the Pacific coast, respectively. The same rate structure, it is averred, would unduly and unlawfully prefer the Pacific terminals, and would unduly and unlawfully prejudice the intermountain region in their respective rôles as customers or purchasers in markets east of the Colorado common points.

The carriers are not expecting, by reason of the low terminal rates, to meet in any large measure water competition from points on the Atlantic or the Gulf. They are interested primarily in securing certain traffic which originates inland, such as iron and steel at Pittsburgh, which now moves largely by rail to Baltimore and thence by water to the Pacific. Accordingly the carriers name an all-rail rate from Pittsburgh to the Pacific slightly in excess of the going rail-and-water rates, rail to Baltimore and water thence to the Pacific. If they did no more than this, and did it on a similar basis for each inland iron and steel producing group, they might well be within their rights and within the law, provided the rates conformed to the other criteria named herein. But having thus fixed a rate from Pittsburgh to the Pacific, they proceed to blanket this rate from all points of origin from the Atlantic to the Missouri River or even westward. Moreover, they propose at the same time to keep in effect rates from all eastern origins in the same territory to intermountain destinations graded roughly according to the respective lengths of the hauls.

For example, Pittsburgh is accorded a rate of $1 on item No. 10, iron and steel, to Pacific terminals because Pittsburgh can move the freight to Baltimore for 35 cents, and thence by water for approximately 60 cents or less. Pittsburgh, in other words, is given—perhaps appropriately given—a $1 rate, in place of its present $1.665 rate, because of its advantage of location in respect of the Atlantic seaboard. But the same reason can not justly be given for applying this same rate to iron and steel originating, let us say, at Chicago, or the Missouri River. The all-rail rate, Chicago to Baltimore, is 60 cents, thence by water to the Pacific, 60 cents or less, making a through rail-and-water rate of $1.20 measure approximately Chicago's relative advantage of location [1] via rail and the Atlantic seaboard. Wholly with the avowed pur-

[1] Chicago is taken as illustrative, without passing upon the claim that via the Mississippi and the Gulf Chicago has a rail-and-water rate comparable with Pittsburgh's rail-and-water rate to the Pacific.

pose of inducing competitive shipments from Chicago or the Missouri River to the Pacific, the region west of Pittsburgh is accorded a preferentail rate structure, which is based on "market competition." But if Pittsburgh and Chicago and Omaha all ship to Reno or Spokane, Pittsburgh is still to be compelled to pay a higher rate than Chicago, and Chicago a higher rate than Omaha, and thus the more distant points suffer the disability of the longer hauls required.

The route, rail and water, is available to Pittsburgh at 35 cents (rail) *plus* 60 cents (water), a total of 95 cents. If, therefore, iron and steel are to move from Pittsburgh, all rail, west to the Pacific, it must have a rate not much over 95 cents. Chicago, however, if it moves its iron and steel via Baltimore, must pay 60 cents (rail) *plus* 60 cents (water), or $1.20. Whether Chicago moves its iron and steel all rail, or rail and water via the Atlantic, Pittsburgh has available a route 20 cents cheaper. Via the Atlantic seaboard Chicago therefore is at a distance disadvantage, from the Pacific, of 600 miles, or in this case, of 20 cents per 100 pounds.

The carriers seek to justify this proposed rate structure on the ground that otherwise manufacturing will tend to be further concentrated on the congested Atlantic seaboard. They represent that their proposed rate structure will beneficially distribute manufacturing throughout the Middle West and Central West. But this they may not do, unless it can be done without creating undue rate preferences. . . .

The fact is well urged by the intermountain interests that the proposal to blanket all-rail rates from the Atlantic seaboard to the Missouri River, or even to the Colorado common points, will enable Pacific coast purchasers to buy in any market in this vast domain under an equality of freight rates, and thus to profit by the widest competition. The intermountain country will continue under the handicap that in purchasing in the same region it must pay more in freight on articles purchased in Pittsburgh than in Chicago and more on articles purchased in Chicago than in Kansas City. In other words, their markets are restricted, whereas the Pacific slope purchasers may disregard distance in their choice of an eastern market.

We find that the general westbound application of these transcontinental carriers for authority to depart from the long-and-short-haul provision of the fourth section of the interstate commerce act on this record should be denied. . . .

CAMPBELL, *Commissioner*, concurring in part:

I concur in the conclusions of the majority in denying certain of the applications. It is my view, however, that the construction placed upon the 1920 amendment of the fourth section does not recognize the full intent of Congress. To my mind "reasonably compensatory" as used in the amendment means a rate equal in amount to a "nonconfiscatory rate." I fail to find any decisions of this commission giving any other interpretation to the words.

In *Morgan Grain Co.* v. *A. C. L. R. R. Co.*, 19 I. C. C., 460, at page 470, this commission approved the meaning of compensation as defined by Mr. Justice Brewer in the following quotation:

> Compensation implies three things: Payment of cost of service, interest on bonds, and then some dividend. Cost of service implies skilled labor, the best appliances, keeping of the roadbed and the cars and machinery and other appliances in perfect order and repair. The obligation of the carrier to the passenger and the shipper requires all these. They are not matters which the carriers can dispense with, or matters whose cost can by them be fixed. They may not employ poor engineers, whose wages would be low, but must employ competent engineers, and pay the price needed to obtain them. The same rule obtains as to engines, machinery, roadbed, etc., and it may be doubted whether even the legislature, with all its power, is competent to relieve railroad companies, whose means of transportation are attended with so much danger, from the full performance of this obligation to the public. The fixed charges are the interest on the bonds. This must be paid, for otherwise foreclosure would follow, and the interest of the mortgagor swept out of existence. The property of the stockholders can not be destroyed any more than the property of the bondholders. Each has a fixed and vested interest, which can not be taken away. (*C. & N. W. Ry. Co.* v. *Dey*, 35 Fed. Rep. 879.)

That Congress had this definition in mind I think is clearly shown by the debates in Congress. This interpretation of the meaning of the words "reasonably compensatory" does not make the fourth section absolute as contended by the carriers. There is a certain amount of flexibility in the "twilight zone" of reasonableness; that is, the difference that may exist between a nonconfiscatory rate and a reasonable maximum rate. . . .

PART III

RAILROAD SERVICE

CHAPTER XIII

SAFETY OF SERVICE [1]

1. SAFETY OF EMPLOYEES [2]

BY THE COMMISSION:

Hearing was had on the application filed March 2, 1920, by the American Railroad Association on behalf of various carriers for a further extension of time within which to make their freight-train cars conform to certain of the standards of equipment prescribed by us in our order of March 13, 1911, made pursuant to the provisions of section 3 of the act of Congress of April 14, 1910, 36 Stat. L., 298, known as an act to supplement the safety appliance acts. . . . The period fixed by us having expired, it became unlawful under the provisions of the act to use any car not conforming with the standards so prescribed by us. Under a strict construction of the law a doubt arises as to whether there was any intention on the part of Congress to authorize us to suspend the operation of the statute with respect to standardization of equipment after its terms once became effective.

Aside from the question of our jurisdiction, however, the record shows that on February 1, 1920, there were 2,319,380 freight cars owned by the carriers represented at the hearing, and that 60,170 of these, or 2.6 per cent of the total owned, were not equipped in conformity with the standards prescribed by our order of March 13, 1911. It is estimated that 3,000 were equipped during the month of February, and that 12,021, or 20 per cent, were special service cars or cars which do not leave the line of the owning carrier. No reason was given why these 12,021 special service cars have not been equipped in conformity with the law or why they can not immediately be so equipped. This leaves 45,149 other cars to be equipped. Sixty per cent of them need minor repairs only, but more or less difficulty is involved in equipping the remaining 18,060. Of these, 9,272 have less than 10 inches end-ladder clearance. If a special drawbar is used, the larger percentage of the 9,272 cars can be made to conform to the requirements. The

[1] See Jones, pp. 375-388, 558, and Vanderblue and Burgess, pp. 223–236.
[2] *Safety Appliances*, 58 I. C. C. 655 (August 7, 1920).

number of bad-order cars on the lines of these carriers is about 138,000, or approximately 6.5 per cent of the total number owned. The percentage of the number of bad-order cars has fluctuated during the last two or three years between a little over 5 and about 10 per cent. Most, if not all, of these nonequipped cars have been through the shops in the last 9 or 10 years. A witness for the carriers stated that he did not know that any freight car could stay out of the shop that long.

It can not be maintained that the failure to have these cars equipped in conformity with the standards is due to any unforeseen contingency. The requirement for the standardization of safety-appliance equipment is of long standing, and attention has been directed to this requirement from time to time in previous hearings in this matter as well as in the several extension orders; at the hearing in August, 1919, the situation was discussed and the understanding was had that no further extension would be necessary, asked, or granted. The arguments that shortage of material and absence of the cars from the lines of the owning carriers have delayed the required standardization are not convincing with respect to those cars which require only minor repairs, inasmuch as safety appliances are of standard dimensions and an order issued by the Railroad Administration June 30, 1919, required each carrier to equip all cars on its line not already standardized, regardless of ownership. We have seen that it will be more or less difficult to make 18,060 cars conform to the standards. But if these 18,060 cars are added to the number of bad-order cars, shown by the record to exist on the lines of the carriers, the percentage of bad-order cars will be increased less than 1 per cent, or from 6.5 to 7.3 per cent; and if the entire 60,000 cars not equipped according to standard were added to the number of bad-order cars the percentage of such cars would be increased to 9.2 per cent, a figure less than the maximum, which, according to the record, has existed during the past two or three years.

It is noted that all of the unstandardized cars referred to herein were in service July 1, 1911, and all of them are consequently 9 or more years old. No doubt many of these cars have practically outlived their usefulness and nearly reached the age of retirement. Cars of that age, if they have not heretofore been shopped for extensive repair work, must shortly go through the shops, at which time the safety-appliance equipment can and must be made to conform to the standards.

We have been very liberal in the past in granting successive extensions of time; in previous hearings on this subject, we have been convinced that good cause was shown for the extensions granted, notwithstanding that representatives of train-service employees in every case have opposed any further extension of time. We are not unmindful of the fact that the primary purpose of the safety-appliance law and standards is to reduce the hazard of employment, and that extension of time within which carriers are required to comply with the standards delays the consummation of the beneficent purposes of the law. The hazard to employees does not diminish in the same proportion as the number of cars which are not standardized diminishes. The employees expect all safety-appliance equipment they are required to use to be standard, and when a car on which the equipment is not standard is used the fact frequently is not discovered by employees until after an injury has resulted.

Upon consideration of all the facts of record we are of opinion and find that good cause has not been shown for any further extension of the period of compliance and that serious burden or hardship will not be imposed upon the carriers or upon the public by denying the application in this case.

An order denying the application will be entered.

2. Automatic Train Control [1]

By the Commission:

This is a proceeding under section 26 of the interstate commerce act which authorizes us, after investigation, to prescribe the installation of automatic train-stop or train-control devices or other safety devices, upon the whole or any part of the railroad of any carrier by railroad subject to the act.

On January 10, 1922, we entered an order under which certain specified carriers, hereinafter referred to as respondents, were given an opportunity to show cause, if any, why an order should not be entered requiring the installation of automatic train-stop or train-control devices upon designated portions of their lines. Accompanying the order to show cause was a report which set forth the results of investigations conducted up to that time, and a proposed order containing specifications and requirements for

[1] *Automatic Train Control Devices*, 69 I. C. C. 258 (June 13, 1922). Subsequent Commission opinions on this subject are *Automatic Train Control Devices*, 85 I. C. C. 403 (December 17, 1923) and 91 I. C. C. 426 (July 18, 1924). See Vanderblue and Burgess, pp. 234–236.—Ed.

the installation of such devices. The order required each respondent to install, on a designated portion of its road, an automatic train-stop or train-control device in accordance with said requirements. Hearings have been had upon the order to show cause at which all the respondents except nine, were represented by a general committee, and at which carriers individually presented data and arguments.

Respondents represented by the committee opposed generally the entry of an order at this time upon the grounds: First, that there has not been any automatic train-stop or train-control device developed to an extent which would justify the issuance of an order; second, that the carriers have not had opportunity to make adequate service tests of devices which differ fundamentally in their principles of operation from those now installed and in operation under service conditions, which were referred to in our report; third, that every reasonable effort is being made by the carriers to cooperate with the commission for the purpose of testing and developing devices which will best meet operating requirements; fourth, that the order requires a much greater number of and more extensive installations than are warranted, in view of the present state of the art; fifth, the costs of installation and maintenance of automatic train-stop or train-control devices are high and not within the present financial abilities of the roads. In connection with this objection it is contended that it should first be determined whether automatic train-stop or train-control devices will provide equal or greater additional safety for a specified expenditure than a like expenditure for automatic block signals, double-track extensions, interlocking plants, additional steel equipment, under-crossing and grade separation; most of which, it is urged, not only increase safety but increase the capacity of a railroad and produce economies in operation. . . .

Action by the Congress upon the subject of automatic control of trains was first taken on June 30, 1906, when by joint resolution the Interstate Commerce Commission was directed to "investigate and report on the use of and necessity for block signal systems and appliances for the automatic control of railway trains in the United States." 34 Stat. L., 838.

In compliance with this resolution we conducted an investigation, one of the main features of which was an "inquiry into the methods of stopping trains in the event of failure of an employee, for any cause, to obey a signal indication." In the report of this

investigation, made to Congress on February 23, 1907, it was recommended that investigation by official tests of automatic appliances for control of railway trains be authorized, with an appropriation to conduct such tests.

Acting upon this recommendation the Congress in March, 1907, appropriated $50,000 to enable us to further investigate these matters and to conduct experimental tests. A special board, known as the block-signal and train-control board, was appointed by us in July, 1907, to carry on the work. For five years the board devoted its time to an intensive study of the subject, to investigations of numerous automatic train-stop and train-control devices and tests of devices which were believed to have merit. Reports were made each year setting forth the work done, the number and types of devices examined and tested, and the conclusions reached. In its fourth annual report December 11, 1911, the board stated that the art of automatic train control was then far enough advanced to warrant the installation of available devices with a view to their further development to meet the demands of safety in train operation. The board was convinced, as a result of its four and one-half years' work, that if the use of automatic control devices were required in particularly dangerous locations the carriers would have no difficulty in protecting train movements in a manner fully to meet the demands of safety. The board further said:

Few, if any, of the mechanical or electrical elements entering into the construction of automatic train-control systems involve any new principles, nor are they materially different from the elements used by the railroads in the every-day operation of their interlocking and block signals, train brakes, and other devices. The ingenuity and initiative which have been manifested by railroad engineers in the development of much of the apparatus used in the conduct of railroad business greatly exceeds, in the opinion of the board, that required to produce apparatus which can be superimposed upon existing signal systems adequately to compel obedience to the signal indications.

The railroads have been decidedly lax in developing the automatic stop and progress has been so slight in this direction that the actual experience which is necessary for the formation of proper legislative judgment is lacking. The board, therefore, does not believe that at the present time legislative compulsion to this end would be wise; it does believe, however, that the railroads should be urged and expected to develop the art of automatic train control so as to provide devices which will meet their operating conditions. This appears to the board to be entirely prac-

ticable, and should it not be done with a reasonable degree of expedition, steps should be taken by the Government to stimulate such action.

The conclusion of the board was that the information obtained from tests, together with knowledge of the general state of development of the art of automatic train control, showed that there were several types of apparatus and methods of application which, if put into use by the railroads, would quickly develop to a degree of efficiency adequate to meet all reasonable demands; and that such devices properly installed and maintained would add materially to safety in the operation of trains. In many situations, under conditions existing in this country, the board was convinced that the use of automatic train stops was necessary to the safe operation of trains.

The final report was made on June 29, 1912. During its existence the board investigated numerous devices and finally presented a list of 18 automatic train-control devices which it considered to possess sufficient merit to warrant tests under operating conditions.

After the board's work terminated investigation of automatic train-control devices lapsed until October 22, 1913, when an appropriation of $25,000 was made by the Congress. The work was assigned to the division of safety appliances of the commission, later known as the bureau of safety. This bureau continued the investigation from 1913 to 1920, along the same lines as the block-signal and train-control board; it continued the tests arranged for by the board and conducted others.

The reports of the bureau for 1917, 1918, and 1919 show the extent of further tests of various types of devices. Five special reports were made to the Congress by us upon tests of certain devices, including intermittent electrical-contact types, a magnetic-induction type, and a type employing an insulated portion of the train and a short insulated track section. The conclusions arrived at were that the principles upon which the devices were intended to function were fundamentally sound and that they were capable of development to meet the requirements of practical service. It was strongly emphasized that further development work had to be done under actual service conditions with an installation upon a considerable length of track where the traffic handled would furnish the necessary conditions to enable the several problems involved in automatic train control to be worked

out. The investigations of the bureau of safety supplemented the work of the block-signal and train-control board. They resulted in the same conclusions that the board had announced in 1911.

The conclusions reached as a result of the practically continuous investigations conducted from 1906 to 1920 were thus identical in substance, namely, that automatic control of trains is practicable; that the use of automatic train-stop or train-control devices is desirable as a means of increasing safety; and that the development of automatic train-control devices had reached a stage warranting the installation and use of such devices on a more extended scale.

The results of these investigations, which had been reported by us year by year to the Congress, and the recognized need for some such device resulted in the inclusion in the transportation act, 1920, of a section which places upon us the duty, after investigation, of ordering the carriers or any of them to install upon the whole or any part of their lines automatic train-stop or train-control devices or other safety devices which comply with specifications and requirements prescribed by us. That section, section 26 of the interstate commerce act, provides:

> That the Commission may, after investigation, order any carrier by railroad subject to this act, within a time specified in the order, to install automatic train-stop or train-control devices or other safety devices, which comply with specifications and requirements prescribed by the Commission, upon the whole or any part of its railroad, such order to be issued and published at least two years before the date specified for its fulfillment.

Following the enactment of that section we were urged to order the installation of various automatic train-control devices. We were not disposed, however, to issue an order without a review of past investigations and performances and a further investigation, together with a thorough check under our own supervision, of the actual performances of these devices as installed and in operation.

With that end in view and in order to carry out the provisions of section 26 in the most effective and expeditious manner, we invited the cooperation of the American Railway Association. A joint committee on automatic train control consisting of representatives of the signal section and the operating, engineer, and mechanical divisions of that association was appointed in Novem-

ber, 1920. In presenting the matter to the joint committee we said:

Numerous tests of automatic train control devices have been made, but there has been little effort to coordinate this work and to forestall unnecessary duplication of tests of substantially similar devices. As a result there are a number of devices listed in published reports, the functions of which can readily be accomplished under service conditions, but the adaptability of which to meet the varied operating conditions and requirements has not been thoroughly established.

In the administration of section 26 of the interstate commerce act the preliminary work may be regarded as already accomplished. Exhaustive studies and comprehensive reports have been made and experimental tests have been conducted, the records of which are available. The next steps to be taken are the selection of one or more suitable locations on railroads equipped with automatic block signals where automatic train control installations may be made sufficient in extent to determine beyond question the practical utility of systems of this character; specifications and requirements to which the device to be installed in a designated location must conform are then to be prepared; the device is to be selected, and installed in accordance with these specifications and requirements; it is to be placed in service and kept under close observation for whatever length of time may be necessary.

The essential safety function of any automatic train-stop device is to stop a train where a dangerous condition exists ahead of the train, when the engineman for any cause fails to take proper action to stop. Several types of apparatus have been designed to do this. Additional features have been introduced so as to afford speed control, whereby a train may be brought down automatically to a predetermined safe speed at certain fixed locations which are established with relation to the fixed signals of a block system.

In the most recent development of automatic train-control devices, continuous control is obtained whereby the engineman is not dependent upon indications received at fixed locations, but is immediately made aware of a change in condition ahead of his train and may act promptly to govern his train accordingly, but in the event of his failure so to do the device automatically operates to protect the train either by slowing it down or by stopping it.

The degree of control desired by a railroad will depend upon the particular operating and traffic conditions upon its road, and it is for this reason that automatic train-control devices have been further developed to provide functions in addition to the simple

automatic stop. Our order recognized that fact and defined an automatic train-stop or train-control device as a system or installation so arranged that its operation will automatically result in either one or the other or both of the following conditions; first, the application of the brakes until the train has been brought to a stop, and, second, the application of the brakes, when the speed of the train exceeds a prescribed rate, until the speed has been reduced to a predetermined and prescribed rate.

Our investigations have shown that a number of types of devices are available to meet the requirements laid down by us. The results desired may be obtained, for example, by means of a mechanical trip, placed between or beside the running rails, or overhead, by impact with which an arm or lever projecting from the locomotive or tender is moved so as to operate the power-brake mechanism on the locomotive; electrically, by means of a ramp placed outside of and parallel to the running rails and a shoe placed upon the locomotive or tender in a position where it will come into contact with the ramp as the locomotive or tender passes the ramp location; electrically, by track-rail contact; and by induction, without any contact between train apparatus and roadside apparatus, whereby the operation of the locomotive train-control apparatus is made to depend upon effects produced by either magnets or inert elements placed at certain fixed points between or outside the running rails, or by the effects produced by electric currents carried in the running rails.

The control obtained may be termed intermittent where indications or impulses are received only at certain fixed points, or continuous where, as before stated, immediate and continuous indications are received by the engineman. . . .

EFFECT ON TRACK CAPACITY

Respondents, through their committee, state that the installation of automatic train-control devices upon lines handling heavy traffic will tend to slow up train movements and to decrease track capacity, and, therefore, may require the addition of more running tracks to accommodate the same volume of traffic.

The automatic train-control committee of the railroad administration discussed this problem in its report to the Director General of Railroads December 31, 1919, as follows:

A properly operated automatic block-signal system adds to the capacity of a railroad by increasing the freedom and flexibility

of train movements over it. This condition should not be unduly interfered with by the use of an automatic train-control device. It is apparent, however, that if such a device is to act to stop a train only in the occurrence of those emergencies caused by the failure of employees to obey signal indications the automatic brake application must be made a sufficient distance away from the actual point of danger to bring the train to a stop before reaching that point, under the most unfavorable conditions. This involves the necessity of providing maximum braking distance for all trains equal to that required for any train on the road.

This cannot be done without decreasing the track capacity, and on congested railroads is therefore a matter for serious consideration. To overcome these difficulties permissive features have been installed to enable the engineman to nullify the brake application and speed-control apparatus is being developed.

It is obvious that this difficulty arises only upon roads and portions of roads now operating to full capacity or nearly so. The problem is one not generally confronting all the respondent carriers, and arises, with respect to some of them, only in connection with operations over certain sections of their roads. In some locations a simple automatic stop will be adequate. In others speed control may be necessary or desirable or automatic stops on part of the line and speed control on other parts where traffic is heavy may be needed to provide safety in operation and at the same time satisfactorily meet traffic conditions.

COST

The cost of installing automatic train-control devices depends upon the nature of the particular installation, the number of locomotives to be equipped, the type of device selected, and the extent of train control that is desired.

The cost per mile of road and per mile of track can not be stated generally, for the reason that the number and length of blocks, and hence the number of indication points required per mile upon any road depend upon the operating conditions. The cost for locomotive apparatus and for roadside or track apparatus will therefore be given, together with the cost of the installations which have been under observation.

From the various figures submitted by respondents and by proprietors and manufacturers it appears that the cost of locomotive apparatus for an intermittent-control device of the ramp type ranges from $400 to $1,000; for an intermittent-control device of

the induction type from $375 to $2,100; and for a continuous-control device, induction type, from $1,000 to $3,000. Assuming one indication point per block the cost of track equipment of the ramp type is from $200 to $550 per block; of the induction type, intermittent control, from $400 to $2,000 per block; and of the induction type, continuous control, from $300 to $1,000 per block. These prices cover installation costs and are stated to be the maximum prices for each unit of the particular device. They may be reduced when the apparatus is manufactured and installed upon a large scale. . . .

Many of the respondents have filed estimates of the cost of installation upon selected portions of their roads, comprising passenger-locomotive divisions, which show a much higher cost than those indicated in the foregoing figures. The estimated figures show a wide variation both for engine equipment and roadway equipment. The differences are due in part to the type of device selected and the measure of control to be secured and in part to the varying number of locomotives to be equipped and the number of indication points upon the road.

With these figures as bases they urge that a greater degree of safety might be secured by spending the money to eliminate grade crossings, to extend their automatic block-signal systems and interlocking plants, and to construct additional tracks. All of these are unquestionably desirable. Automatic train control, however, will still be a necessary safety measure when all of these things shall have been completed. The compensation from a financial standpoint which will result from securing added safety should not be overlooked, however, when costs are being considered.

The accident reports made by the railroads to us show that from January 1, 1906, to December 31, 1921, there were 26,297 head-on and rear-end collisions. These resulted in death to 4,326 persons and injury to 60,682. The damage to railway property alone amounted to $40,969,663. The annual average of these collisions amounted to 1,643; the average number killed, 270; and the average number injured, 3,792. The average damage to railroad property amounted to $2,560,603 per year. Losses due to damage to lading are not included in these figures but they are no doubt considerable. If to the large property losses there be added the death losses and the damages paid for persons injured, the total amount will be very great. . . .

We are convinced that the carriers can, if they are determined to do so, readily install upon their roads devices which will meet the requirements of safety and which at the same time will not unduly interfere with operating requirements. Had the railroads taken prompt action when the block-signal and train-control board pointed the way in 1911, the art would have been far advanced to-day. Many of the operating problems, such as interchangeability, effect on track capacity, and others which respondents have stressed in this proceeding, would have been solved. The development of the automatic block-signal system to its present state of efficiency is evidence of what can be accomplished.

It is evident from the record that automatic block signals were primarily installed as a means of increasing the capacity of existing lines. Such a system permits of the operation of more trains at increased speeds. This very fact, however, increases the possibility of accidents. Much has been done to furnish the engineman with reliable information, by means of wayside signals, of the conditions of the track ahead, but progress has been slow in providing means to automatically compel obedience to the signal indications. The fact remains that the correct operation of trains in compliance with the signals still depends entirely upon the knowledge, alertness, and skill of the engine crew. The danger is ever present that the engineman may fail to observe, correctly interpret, and obey the signals. Our accident reports have repeatedly shown this to be true. From January 1, 1911, to March 31, 1922, we investigated 80 collisions, which occurred upon automatic block-signaled lines, due directly or indirectly to the failure of enginemen to observe or to be governed by signal indications. These accidents caused the death of 416 persons and injury to 1,837. The conclusion is inevitable that disastrous collisions will continue to occur unless and until automatic train-control devices are installed to protect against human failure.

Our investigations have shown that the art of automatic train control has long since passed the experimental stage. No safety devices such as the automatic coupler, the air brake, and the automatic block signal were perfected to as high a degree as the automatic train-control devices before they were either ordered installed or were voluntarily adopted.

The 15 years of investigation and study and the results obtained in the actual employment of these devices over periods of years

upon some of the railroads have clearly demonstrated the practicability of and the necessity for automatic train stops or train control. The time has now arrived when the carriers should be required to select and install such device or devices as will meet our specifications and requirements.

TIME FOR COMPLIANCE

Under the act our order must be issued and published at least two years before the date specified for its fulfillment. The fixing of a time limit should be based upon a consideration of the time which has already run since the passage of the act and the progress and present state of the art. There should be considered also the time reasonably required to enable the carriers to select suitable devices from among those available, to develop them to meet their operating conditions and requirements in the designated locations, and to provide for the manufacture and installation of the apparatus.

Some of the respondents contend that devices of the ramp type are unsuited to their needs and hence undesirable. They state that devices employing the induction principle will better meet their requirements, and therefore desire more time in which to test such devices. This is necessary, they believe, because there has been relatively less development of the induction type as compared with the ramp type. Proprietors and manufacturers of devices of the induction type support, in some measure, this request, because they are of the opinion that unless more time is allowed, respondents will perforce be limited to the employment of devices of the ramp type. . . .

We do not desire to force any carrier to adopt a particular type which it believes is not entirely suitable to its peculiar needs, if there are others available which, within a reasonable time, may be shown to be more suitable. In view, however, of the investigations which have already been made and the time which has elapsed, we are of the opinion that a six months' period will give sufficient time for any road to decide upon the device it should select. Within this time, provided a sufficient installation is made and intensive tests of the device are conducted, it can be determined whether or not the device will be suitable.

Respondents will be required to make monthly reports to us during the six months' period beginning July 1, 1922, of their arrangements for such tests and of the progress made. . . .

3. Hours of Service [1]

Mr. Justice Hughes delivered the opinion of the court.

This is a bill in equity to annul an order made by the Interstate Commerce Commission on March 3, 1908, and for injunction. The order required the carriers . . . to make monthly reports, under oath, showing the instances where employés subject to that act had been on duty for a longer period than that allowed. . . .[2]

By stipulation there were introduced into record additional instructions issued by the Commission under date of August 15, 1908. These prescribed new forms, and also a separate form of oath for use in case there had been no excessive service; and it was

[1] *Baltimore & Ohio Railroad Company* v. *Interstate Commerce Commission,* 221 U. S. 612 (May 29, 1911).

[2] The important provisions of the "Hours of Service" Law (reprinted in full in a footnote to the decision) are contained in Sections 2 and 3 of that Act.—Ed.

"Sec. 2. That it shall be unlawful for any common carrier, its officers or agents, subject to this Act, to require or permit any employé subject to this Act to be or remain on duty for a longer period than sixteen consecutive hours, and whenever any such employé of such common carrier shall have been continuously on duty for sixteen hours he shall be relieved and not required or permitted again to go on duty until he has had at least ten consecutive hours off duty; and no such employé who has been on duty sixteen hours in the aggregate in any twenty-four-hour period shall be required or permitted to continue or again go on duty without having had at least eight consecutive hours off duty: *Provided,* That no operator, train dispatcher, or other employé who by the use of the telegraph or telephone, dispatches, reports, transmits, receives, or delivers orders pertaining to or affecting train movements, shall be required or permitted to be or remain on duty for a longer period than nine hours in any twenty-four-hour period in all towers, offices, places, and stations continuously operated night and day, nor for a longer period than thirteen hours in all towers, offices, places, and stations operated only during the daytime, except in case of emergency, when the employés named in this proviso may be permitted to be and remain on duty for four additional hours in a twenty-four-hour period on not exceeding three days in any week: *Provided further,* The Interstate Commerce Commission may after full hearing in a particular case and for good cause shown extend the period within which a common carrier shall comply with the provisions of this proviso as to such case.

"Sec. 3. That any such common carrier, or any officer or agent thereof, requiring or permitting any employé to go, be, or remain on duty in violation of the second section hereof, shall be liable to a penalty of not to exceed five hundred dollars for each and every violation, to be recovered in a suit or suits to be brought by the United States district attorney in the district court of the United States having jurisdiction in the locality where such violation shall have been committed; and it shall be the duty of such district attorney to bring such suits upon satisfactory information being lodged with him; but no such suit shall be brought after the expiration of one year from the date of such violation; and it shall also be the duty of the Interstate Commerce Commission to lodge with the proper district attorneys information of any such violations as may come to its knowledge. In all prosecutions under this Act the common carrier shall be deemed to have had knowledge of all acts of all its officers and agents: *Provided,* That the provisions of this Act shall not apply in any case of casualty or unavoidable accident or the act of God; nor where the delay was the result of a cause not known to the carrier or its officer or agent in charge of such employé at the time said employé left a terminal, and which could not have been foreseen: *Provided further,* That the provisions of this act shall not apply to the crews of wrecking or relief trains."

further directed that reports of hours of service of the employés described should be made by the secretary or similar officer of the carrier. . . .

First. Although the question was not specifically raised by the bill, it is now contended that the statute is unconstitutional in its entirety and therefore no action of the Commission can be based upon it. It is said that it goes beyond the power which Congress may exercise in the regulation of interstate commerce; that while addressed to common carriers engaged in interstate transportation by railroad to any extent whatever, its prohibitions and penalties are not limited to interstate commerce, but apply to intrastate railroads and to employés engaged in local business.

The prohibitions of the act are found in § 2. This provides that it shall be "unlawful for any common carrier, its officers or agents, subject to this Act, to require or permit any employé subject to this Act to be or remain on duty" for a longer period than that prescribed. The carriers and employés subject to the act are defined in § 1 as follows:

"That the provisions of this Act shall apply to any common carrier or carriers, their officers, agents, and employés, engaged in the transportation of passengers or property by railroad in the District of Columbia or any Territory of the United States, or from one State or Territory of the United States or the District of Columbia to any other State or Territory of the United States or the District of Columbia, or from any place in the United States to an adjacent foreign country, or from any place in the United States through a foreign country to any other place in the United States. The term 'railroad,' as used in this Act, shall include all bridges and ferries used or operated in connection with any railroad, and also all the road in use by any common carrier operating a railroad, whether owned or operated under a contract, agreement, or lease; and the term 'employés,' as used in this Act, shall be held to mean persons actually engaged in or connected with the movement of any train."

No difficulty arises in the construction of this language. The first sentence states the application to carriers and employés who are "engaged in the transportation of passengers or property by railroad" in the District of Columbia or the Territories, or in interstate or foreign commerce. The definition in the second sentence, of what the terms "railroad" and "employés" shall include, qualify these words as previously used, but do not remove the limitation as to the nature of the transportation in which the employés must be engaged in order to come within the provisions

of the statute. If the definition, in the last part of the sentence, of the words used in the first part be read in connection with the latter the meaning of the whole becomes obvious. The section, in effect, thus provides: "This act shall apply to any common carrier or carriers, their officers, agents, and employés (meaning by 'employés' persons actually engaged in or connected with the movement of any train), engaged in the transportation of passengers or property by railroad (meaning by 'railroad' to include all bridges and ferries used or operated in connection with any railroad) in the District of Columbia or any Territory . . . or from one State . . . to any other State," etc. In short, the employés to which the act refers, embracing the persons described in the last sentence of the section, are those engaged in the transportation of passengers or property by railroad in the district, territorial, interstate or foreign commerce defined; and the railroad, including bridges and ferries, is the railroad by means of which the defined commerce is conducted.

The statute, therefore, in its scope, is materially different from the act of June 11, 1906, chapter 3073, 34 Stat. 232, which was before this court in the *Employers' Liability Cases*, 207 U. S. 463. There, while the carriers described were those engaged in the commerce subject to the regulating power of Congress, it appeared that if a carrier was so engaged the act governed its relation to every employé, although the employment of the latter might have nothing whatever to do with interstate commerce. In the present statute, the limiting words govern the employés as well as the carriers.

But the argument, undoubtedly, involves the consideration that the interstate and intrastate operations of interstate carriers are so interwoven that it is utterly impracticable for them to divide their employés in such manner that the duties of those who are engaged in connection with interstate commerce shall be confined to that commerce exclusively. And thus, many employés who have to do with the movement of trains in interstate transportation are, by virtue of practical necessity, also employed in intrastate transportation.

This consideration, however, lends no support to the contention that the statute is invalid. For there cannot be denied to Congress the effective exercise of its constitutional authority. By virtue of its power to regulate interstate and foreign commerce, Congress may enact laws for the safeguarding of the persons and property

that are transported in that commerce and of those who are employed in transporting them. . . . The fundamental question here is whether a restriction upon the hours of labor of employés who are connected with the movement of trains in interstate transportation is comprehended within this sphere of authorized legislation. This question admits of but one answer. The length of hours of service has direct relation to the efficiency of the human agencies upon which protection to life and property necessarily depends. This has been repeatedly emphasized in official reports of the Interstate Commerce Commission, and is a matter so plain as to require no elaboration. In its power suitably to provide for the safety of employés and travelers, Congress was not limited to the enactment of laws relating to mechanical appliances, but it was also competent to consider, and to endeavor to reduce, the dangers incident to the strain of excessive hours of duty on the part of engineers, conductors, train dispatchers, telegraphers, and other persons embraced within the class defined by the act. And in imposing restrictions having reasonable relation to this end there is no interference with liberty of contract as guaranteed by the Constitution. . . .

If, then, it be assumed, as it must be, that, in the furtherance of its purpose, Congress can limit the hours of labor of employés engaged in interstate transportation, it follows that this power cannot be defeated either by prolonging the period of service through other requirements of the carriers, or by the commingling of duties relating to interstate and intrastate operations.

Second. It is also urged that the statute is void for uncertainty. This objection is based on the wording of the first proviso in § 2 of the act, which is as follows:

"Provided, that no operator, train dispatcher, . . . shall be required or permitted to be or remain on duty for a longer period than nine hours in any twenty-four-hour period in all towers, offices, places, and stations continuously operated night and day, nor for a longer period than thirteen hours in all towers, offices, places, and stations operated only during the daytime, except in case of emergency, when the employés named in this proviso may be permitted to be and remain on duty for four additional hours in a twenty-four-hour period on not exceeding three days in any week."

It is said that the words, "except in case of emergency," make the application of the act so uncertain as to destroy its validity.

But this argument in substance denies to the legislature the power to use a generic description, and if pressed to its logical conclusion would practically nullify the legislative authority by making it essential that legislation should define, without the use of generic terms, all the specific instances to be brought within it. In a legal sense there is no uncertainty. Congress, by an appropriate description of an exceptional class, has established a standard with respect to which cases that arise must be adjudged. . . .

Third. Finding that the objections to the validity of the statute are not well taken, we are brought to the question whether the Interstate Commerce Commission has authority to require the reports called for by its order.

Section 4 of the act provides:

> "Sec. 4. It shall be the duty of the Interstate Commerce Commission to execute and enforce the provisions of this Act, and all powers granted to the Interstate Commerce Commission are hereby extended to it in the execution of this Act."

The Commission, then, may call to its aid in the enforcement of the act "all powers granted" to it. And, although there might have been doubt as to the adequacy of the authority of the Commission, under the law as it formerly stood, to require these reports, there can be none now, in view of the amendment of § 20 of the act to regulate commerce by the act of June 18, 1910, c. 309, 36 Stat. 556. As so amended, this section contains the following provision:

> "The commission shall also have authority by general or special orders to require said carriers, or any of them, to file monthly reports of earnings and expenses, and to file periodical or special, or both periodical and special, reports concerning any matters about which the commission is authorized or required by this or any other law to inquire or to keep itself informed, or which it is required to enforce; and such periodical or special reports shall be under oath whenever the commission so requires."

This clearly embraces the power which the Commission here asserts, and it is certainly now entitled to promulgate an order requiring reports to be made. It follows that as, under the stipulation of record here, the requirement of the Commission is to operate wholly in the future and it has been suspended awaiting the final determination of this cause, the question of the authority of the Commission at the time the order was made has become a

moot one. Were there no other question before us the appeal would accordingly be dismissed, and to justify a reversal of the judgment and the sustaining of the complainant's bill other grounds must appear.

Nor can it be said, so far as the scope of the requirement of the order is concerned, that it goes beyond the authority which has been conferred upon the Commission. The order relates to the employés who are "subject to said act." The bill alleges that, in the original forms prescribed, the carrier was required to show the employés who were "either on duty for a period of time in excess of that contemplated by the act or who had not been off duty after any period of service for the length of time prescribed by the act, and in the case of every such employé the carrier was required to state the cause of and the facts, if any, explanatory of the excess service thus rendered by the employé." By the amended instructions set forth in the stipulation, it appears that "in case no employé has been employed in excess of the time named in said act, and in case no employé has gone on duty with less than the statutory period off duty," a separate form of oath to that effect will be accepted in lieu of the forms which are to be used in detailing excess service. And, as already noted, the reports are to be made by the secretary or similar officer.

To enable the Commission properly to perform its duty to enforce the law, it is necessary that it should have full information as to the hours of service exacted of the employés who are subject to the provisions of the statute, and the requirements to which we have referred are appropriate for that purpose and are comprehended within the power of the Commission.

Fourth. There is the final objection that to compel the disclosure by these reports of violations of the law is contrary to the Fourth and Fifth Amendments of the Constitution of the United States.

The order of the Commission is suitably specific and reasonable, and there is not the faintest semblance of an unreasonable search and seizure. The Fourth Amendment has no application.

Nor can the corporation plead a privilege against self-crimination under the Fifth Amendment. . . . With respect to its officers, it would be sufficient to say that the privilege guaranteed to them by this amendment is a personal one which cannot be asserted on their behalf by the corporation. But the transactions to which the required reports relate are corporate transactions subject to

the regulating power of Congress. And, with regard to the keeping of suitable records of corporate administration, and the making of reports of corporate action, where these are ordered by the Commission under the authority of Congress, the officers of the corporation, by virtue of the assumption of their duties as such, are bound by the corporate obligation and cannot claim a personal privilege in hostility to the requirement. . . .

The decree of the Circuit Court is *Affirmed.*

CHAPTER XIV

ADEQUACY OF SERVICE [1]

1. Car Distribution [2]

Atchison, *Commissioner:*

This is a proceeding of investigation upon our own motion, entered upon March 22, 1921, with respect to the reasonableness and propriety of the present car-distribution rules of the respondents. . . .

Essentially involved is the practice of the carriers as to what are commonly known as assigned cars for the loading of coal. . . . The inquiry necessarily involves the right to make an assignment or designation of certain cars to specific mines for definite shippers or consignees, and the rule to be observed in times of car shortage in counting such cars in the distribution of equipment among the various mines upon the railroad or a division. The propriety of the practice raises the questions as to whether it is in terms forbidden by law; and if not so proscribed, whether the practice is just and reasonable and otherwise conforms to the tests of the interstate commerce act. Three classes of cars are involved: (1) System cars, or cars of railroad ownership, set for loading upon the line of the owning carrier or such as may be on its line of railroad and not owned by some specific shippers or restricted as to use; (2) cars for foreign railway fuel, which are delivered to another carrier consigned to particular mine operators for loading with fuel for the use of the delivering carrier and return to it; and (3) private cars, which include cars owned or leased or subject to the exclusive control of particular persons, not carriers by railroad, who deliver them to the railroad for placement at designated mines for loading and subsequent transportation as desired by the private-car owners. The coal to be transported in the private cars may or may not be intended eventually to be used for railroad fuel.

Counsel for respondents thus summarize the manner in which

[1] On the general subject of service, see Jones, pp. 375–410, 440–441, 558–559, 589–590, and Vanderblue and Burgess, Part III, "Service," pp. 207–303; on adequacy of service, see Jones, pp. 388–399.—Ed.

[2] *Assigned Cars for Bituminous Coal Mines,* 80 I. C. C. 520 (June 13, 1923). See Jones, pp. 394–399, and Vanderblue and Burgess, pp. 252–257.

assigned cars are placed and how they are counted, in connection with other cars, in determining the cars to which mines are entitled when, by reason of car shortage, it is necessary to distribute the available equipment on a basis less than the aggregate of orders based on the respective mine ratings:

> Assigned cars must be placed at mines to which assigned.
>
> If the number of assigned cars exceeds the number of cars to which the mine is that day entitled under the rate of coal car distribution, the mine is not entitled to any additional cars for commercial coal loading that day.
>
> If the number of assigned cars does not equal the number of cars to which the mine is that day entitled under the rate of coal car distribution, the mine shall be given enough system cars in addition to bring its total placements that day up to the number to which it is entitled.

Throughout this report the term commercial mines will be understood as referring to a mine which does not receive assigned cars. . . .

The respondents have proposed for approval a code of rules as to mine ratings and car distribution. As to the assignment and counting of private cars and cars for railroad fuel, their proposal is found in the following suggested rules:

> (8) Private cars, such cars as are assigned to mines for railroad fuel loading in accordance with the decisions of the Interstate Commerce Commission in *R. R. Commission of Ohio, et al.* v. *H. V. Ry. Co.*, 12 I. C. C., 398, and *Traer* v. *Chicago & Alton Railroad Co. et al.*, 13 I. C. C., 451, and cars assigned to mines for loading of other coal upon order of the Interstate Commerce Commission, will be designated as "assigned" cars. All other cars will be designated as "unassigned" cars.
>
> (9) If the number of assigned cars placed at a mine during any period, as provided in rule 8, equals or exceeds the mine's pro rata share of the available car supply, it shall not be entitled to any unassigned cars. The assigned cars, together with the mine's requirements, will be eliminated, and the remainder of the available car supply prorated to the other mines, based on a revised percentage by reason of such elimination.
>
> (10) If the number of assigned cars placed at a mine during any period, as provided in rule 8, is less than its pro rata share, based on a revised percentage, it shall be entitled to receive unassigned cars in addition thereto to make up its pro rata share.

The rules proposed have the general support of the respondent carriers. They are opposed in their entirety by many associations

of mine operators and representatives of mine labor. The National Coal Association, an organization with a large and widespread membership of bituminous-mine operators throughout the United States, opposes the rules in their application to railroad fuel, but takes no position as to the assigned private cars.

I.

The rules proposed are the same as those in effect when the present proceeding was instituted, upon the lines of respondents which followed the practice of assigning cars, except for the addition of the words "and cars assigned to mines for loading of other coal upon order of the Interstate Commerce Commission," in the first rule quoted. It seems to be taken by all parties that the rules quoted, so far as they relate to railroad-fuel cars, expressly promulgate the practice which was put into effect by the carriers following our decision in *R. R. Com. of Ohio* v. *H. V. Ry. Co.*, *supra*, and in *Traer* v. *C. & A. R. R. Co.*, *supra*, which we will hereinafter refer to as the *Hocking Valley case* and *Traer case*, respectively. . . .

A brief review of our previous decisions involving this subject will be helpful.

Prior to 1907 the railroads commonly delivered to coal mines cars privately owned or leased, foreign railway-fuel cars, and cars for the carriers' own fuel loading, according as the cars were consigned or assigned and as the railroad had contracts for purchase of fuel coal. It was the usual practice to refrain from counting or charging such cars against the distributive shares of the mines to which they were given. All such cars were given to the mines for which they were intended and such mines received in addition their full share of the other cars available for distribution. Thus the cars assigned were not counted against the mine, as the phrase commonly ran.

The practice of the carriers in not counting foreign railway-fuel cars and private cars against the mines to which consigned or assigned was brought before us by complaints filed by the Railroad Commission of Ohio against the Hocking Valley Railway Company and the Wheeling & Lake Erie Railroad Company, respectively, which were disposed of together. The second case involved the so-called private cars, claimed to have been bought by certain coal operators, which were not included in or charged against the percentages in distribution of cars to coal-mining companies. Both

complaints put in issue the practice of defendants in permitting the assignment of foreign railway-owned fuel cars consigned to certain coal companies with which the foreign railway had contracts stipulating for the furnishing of cars, and failing to count them against the mines. The basis of both complaints was unjust discrimination under the law as it then stood. And, although the right of the commission to prescribe a regulation or practice in respect to transportation which was just, fair, and reasonable to be thereafter followed was adverted to, the basis of our decision was discrimination. Our decision, made July 11, 1907, has been cited. We held in effect that the private cars and foreign railway-fuel cars as described should be given to the mines to which they were consigned or assigned, but must be counted against the distributive share of the mines. If such specially consigned or assigned cars equaled or exceeded the distributive share of a mine receiving them, the mine should have no additional cars, but if not equal to the distributive share, it should be given only sufficient additional cars to make up its distributive share.

In the *Traer case*, April 13, 1908, we followed the *Hocking Valley case*, and further held that cars used by defendants upon their own lines for transportation of their own necessary fuel supply may be given in any numbers to the mine or mines from which such fuel supply is received, but if such mine or mines also ship commercial coal the fuel cars so supplied must be counted against the mine or mines. An order was made to carry the findings of discrimination into effect. Injunction proceedings brought against the commission by interested carriers resulted in a decree of the Circuit Court of the United States for the Northern District of Illinois enjoining the effect of the order so far as it required carriers to count their own fuel cars against the mine shares, but the order was sustained in other respects. *Chicago & A. R. Co.* v. *Interstate Commerce Commission*, 173 Fed., 930. On appeals by the commission the Supreme Court reversed the decree of the lower court and held the act had delegated to us authority to determine on complaint the question of distribution of the carrier's own freight cars in times of car shortage as a means of prohibiting the undue preference and unjust discrimination forbidden by the act. Power to make the order, and not the expediency or wisdom of it, was the essential issue before the court. *Interstate Commerce Commission* v. *I. C. R. R. Co.*, 215 U. S., 452, *id.* v. *C. & A. R. R. Co.*, 215 U. S., 479. . . .

In our report to the Senate and House of Representatives in *Coal and Oil Investigation*, 31 I. C. C., 193, 218, we repeated the substance of what we had found in the *Hocking Valley* and *Traer cases*. We expressed the view that when the carriers should adjust their rules in accordance with the views of the commission as expressed in the cases cited (and others) no doubt many of the irregularities found to exist would be eliminated.

The rule thus limiting the permissible assignment of cars either privately or railroad owned without counting them against the distributive share of the mines was definitely established and remained in effect as a rule in a state of repose until the advent of Federal control over the railroads and over the production, distribution, and price of coal. That rule was substantially as found in rules 8, 9, and 10 proposed by the respondents, with the exception of reference to cars specially assigned by our order, which is a new addition. The rule was accepted as settled, and although never acquiesced in by commercial mine operators as settled on the right basis, was not the subject of any formal complaint to which our attention has been directed down to the period of Federal control. . . .

II.

Certain premises meet general acceptance in this record. It is recognized that the importance of the railroads in the distribution of coal and other commodities, and their general dependence upon bituminous coal in producing transportation, require that in some lawful way they may be assured of a steady supply of suitable coal. It is likewise generally admitted that, whatever means are adopted to secure such supply, emergencies will occur when the supply will fail unless the railroad is enabled by some means within the law to take sufficient coal ahead of less necessitous uses to keep the flow of traffic going as the public interest requires. There is no dissent from the proposition that confiscation of fuel coal by railroads is a practice to be avoided. It seems to be generally accepted that the public interest requires that the carriers shall not be subjected to unreasonable prices. Obviously the carrier should not be permitted to take advantage of a means provided by the public to insure an uninterrupted movement of traffic, as a means to coerce an unreasonably low price for fuel.

There is enough bituminous coal in the ground in this country to more than supply the demands of all consumers for a long

period. There are more than enough miners to produce coal for all purposes. There are more mines than is consistent with the most efficient use of equipment, and their aggregate capacity exceeds greatly the country's demand. The demands for coal are seasonal, and as a result we have frequent seasonal or local car shortages. In 1916, when we began to feel the effect of the war in Europe, we experienced widespread car shortages, resulting in an investigation by us on our own motion, *Car Supply Investigation*, 42 I. C. C., 657. The more recent general coal-car shortages and the steps taken to insure to carriers their fuel needs have already been adverted to. The aggregate time lost because of car shortages, local and general, is a considerable proportion of the whole of any recent elapsed period of time. And during each period of car shortage the practical problem of supplying the railroads with fuel has been presented sharply, and the meeting of the problem has been most troublesome, and has necessarily involved considerable general disturbance of production and transportation. The large proportionate demand for bituminous coal made by the railroads—nearly 28 per cent of the total consumed and exported by the United States annually—adds to the difficulty of the situation. . . .

The position of the opponents of the assigned car for railway fuel may briefly be summarized as follows: (1) The practice reduces the car supply at commercial mines on certain divisions, since the assigned cars are taken into account in determining the number of cars to which each division as a whole is entitled; (2) it results in a wastage of cars, because a mine loading assigned cars usually has more cars standing over than a mine loading commercial coal; (3) it produces great and harmful inequalities in working time in nearby competing mines; and (4) it affects the price of the coal purchased by the carriers injuriously to the mine operators, and that it results in the shipper buying transportation preference with coal, and the carrier buying coal with transportation preference. These contentions will be dealt with separately.

The effect of the use of the assigned car for railway fuel is to diminish to some extent the supply of cars placed at commercial mines during periods of car shortage. The extent to which the practice causes a diminution in supply is in dispute; the mine operators opposing the practice consider it a serious matter, both because of its direct effect in limiting production, and because of the indirect effects upon their costs and labor supply, while the

carriers minimize the result and even claim compensating advantages to the commercial mines because of the practice. Because of wide differences in the practices of the railroads, and the many fluctuations due to changes in car supply, public clamor for coal, or service orders of the commission, it is extremely difficult to state in precise terms as to a division of a particular line what would have been the effect on the distribution of cars to commercial mines had no cars been assigned; and it is even more difficult to express in any arithmetical manner the result as to the carriers generally. There is much in the record on this subject, which must be weighed in the view of countervailing considerations. The estimates based on individual judgment in some instances indicate the increase in the commercial distribution would have been almost 40 per cent, at the height of the car shortage of 1922. Other testimony indicates a difference of from 10 to 30 per cent. Evidently the private assigned car figures in these estimates, as well as the railway fuel cars. The last column of the following table indicates the increased supply which commercial mines in the various districts on the Chesapeake & Ohio Railway would have received during the year 1920, if there had been a pro rata distribution of all cars, i. e., commercial, system fuel, foreign fuel, and private.

	New River district.	Kanawha district.	Coal River district.	Logan district.	Kentucky district.	Total.
	Per cent.	*Per cent.*	*Per cent.*	*Per cent.*	*Per cent.*	*Per cent.*
Unassigned cars placed, per cent of aggregate orders	50.4	50.9	51.5	51.9	50.1	51.1
Per cent of aggregate orders if all cars prorated	56.7	56.6	55.9	55.8	54.4	56.0
Increase in cars placed, if all prorated, per cent of aggregate orders	6.3	5.7	4.4	3.9	4.3	4.9

In times of shortage, with a strong demand for coal, the orders may be taken as approximating the mine ratings. The percentages now to be quoted are in terms of the aggregate orders. During this same period, on an order for 26,429.1 cars, 25,509.7 cars were assigned for development of new mines, or under service order No. 9 of this commission. If these assignments had not been made, the percentage of unassigned cars placed would have increased

from 51.1 to 52.3 of the orders. If the assignment for railway-fuel and private cars had been abolished, and those cars prorated, the percentage would have further increased to 56. Without private-car assignments, had the private cars remained off the line, the percentage would have decreased from 51.1 to 48.5. If no assignments for railway fuel or of private cars had been made, the former class of cars being prorated to all mines and the latter being no longer on the line, the percentage would have decreased from 51.1 to 50.1. If the assignment for railway fuel had been abolished and the railway-fuel cars prorated to all mines, the percentage would have increased from 51.1 to 52.7.

The weakness of such a showing is that the orders by mines in times of shortage, taken as the base to which each of the percentages stated apply, which approximate the mine ratings, are notoriously far greater than the normal mine capacities, or the ability of the carrier to transport, or the country to consume bituminous coal, when taken in the aggregate. The ratings are merely the factors to be used in determining the relative car supply each mine is to receive, in times of shortage, whether the supply be 10 per cent or 90 per cent of the ratings. More significant would be a comparison of the number of cars which would be placed if all assigned cars were added to those distributed with the number in fact apportioned among the commercial mines. If the second line of percentages shown in the table above be compared with the first line, it will appear that the result of prorating the assigned cars (including private cars as well as those for railroad fuel) with the unassigned would have been to increase the supply of the commercial mines over the cars actually furnished by the following percentages of the cars in fact set:

New River district	12.5 per cent.
Kanawha district	11.2 per cent.
Coal River district	8.5 per cent.
Logan district	7.5 per cent.
Kentucky district	8.6 per cent.
Total	9.6 per cent.

All interests represented take the position that the bituminous coal-mining industry is greatly overdeveloped, and that there is a surplus of labor available for such mines. In times of plentiful car supply, or when the demand for bituminous coal is low, many small or weak mines, which are the least economical to operate, are forced to close. Car shortages are usually accompanied by a

condition of alarm on the part of the consuming public, and a demand for the coal which becomes more excited as the coal-car supply lessens. This encourages the opening of the smaller and weaker mines with the recurrence of a poor car supply, and the parodox is presented that as the car supply becomes worse, the capacity of the open mines increases at even a greater rate. This makes more difficult the process of distribution as the cars in service can not be handled as efficiently, nor can as much coal be transported in the aggregate as if fewer mines were demanding service. The increase in demand and mine rating must be met by a pro rata distribution of the available cars, and thus the supply, already diminished because of the lesser efficiency possible in movement, is further diluted in the process of ratable distribution according to the enlarged capacity. The consequence is that in times of car shortage the commercial operators are in the keenest competition for cars. There is also a competition in the demand for cars as between users of coal. The service orders which we issued in 1920 and 1922 were based upon the insufficiency of the existing supply to meet all needs. Industries which were less vital to the public welfare, but better enabled to pass along their fuel costs, were able to bid up the price of coal for all users, and thus attracted an undue proportion from the more essential uses, to the detriment of the convenience of the public and the commerce of the people. A shortened car supply at commercial mines, from whatever cause, tends in this direction. . . .

The circumstances surrounding and subsequent to our decisions in the *Traer* and *Hocking Valley cases* are such that the practice based upon the rule there announced can scarcely be given the sanctity of long observance in considering the question of reasonableness or undue preference. We have already shown that the power of assignment during Federal control was lodged in the car-service section of the railroad administration. The rule was not reestablished until April 15, 1920. On October 1, 1920, service order No. 18 further limited the rule in its application, and that order, bottomed upon the emergency powers conferred upon us by paragraph 15 (a) of section 1, remained in force until March 24, 1921, when we instituted the present investigation. From 1907 to the latter part of 1918, there was no general coal-car shortage throughout the country except during the latter part of 1912. The rule announced in the *Traer* and *Hocking Valley cases* was never given nation-wide application. As the rule is unimportant to the

carriers in times of car surplus, it was only during the latter part of 1912, and during the latter part of 1916 and 1917, that the carriers in the eastern part of the United States relied in a material way upon the rule in the securing of their fuel. The latter car shortage disappeared in April, 1918, and upon the recurrence of a period of shortage, the railroad administration had ordered the abolition of the practice. Shortly after Federal control was terminated, as previously stated, we assumed control of the situation during the car shortage of 1920, due to the so-called outlaw strike, and exercised our emergency powers until the complete termination of the period of shortage. Similarly, in the recent car shortage due to combined effects of strikes of the bituminous-coal miners and railway shopmen, our special service orders and directions controlled the distribution of equipment for coal loading. Indeed, during the life of certain of our service orders in the shortage of 1922, we notified the carriers that the use of the assigned car was regarded as inconsistent with the letter and the spirit of the general plan of distribution which we were seeking to effectuate. From the beginning of the car shortage of 1916, at least, the operation of the rule has been bitterly contested and opposed by the majority of the commercial-mine operators, and solidly by mine labor whereever organized. . . .

III.

We may now consider use of private cars upon an assigned basis. Much of what has been said as to the practical effects of the practice of assigning railway fuel cars, system and foreign, is equally descriptive of the results of the assignment of private cars. There are certain additional matters which require consideration. In passing, we may repeat that the assignment of private cars was not prohibited by the United States Railroad Administration.

In the *Hocking Valley case* we condemned the long-existing practice of failing to charge private coal cars against the percentages in distribution of cars to coal-mining companies. In effect we held that private cars should be given to the mines to which they were consigned or assigned, but that they must be counted against the distributive share of the mines. If the number of such specially consigned or assigned cars equaled or exceeded the distributive share of a mine receiving them, it should have no additional cars, but if not equal to the distributive share, the mine should be given only sufficient additional cars to make up its distributive share.

Our holding is thus seen to have been a marked limitation upon a practice in effect and was based upon the issue as to undue discrimination or preference. . . .

After the *Hocking Valley case* and subsequent decisions to the same effect, the ownership of private coal cars gradually declined until about 1916. . . . Under the impetus of the war demand for coal and prolonged coal-car shortages, the ownership of private coal cars increased. There can be no doubt the incentive was the more regular and larger car supply provided under the operation of the assigned-car practice. The following statement shows the number of privately owned coal and coke cars as of January 1, 1913, and for each year from 1916 to 1922:

Year.......	1913	1916	1917	1918	1919	1920	1921	1922
Cars........	24,140	14,789	14,879	16,933	20,481	18,955	28,411	27,827

The record indicates that the increase in the ownership of the private cars within recent years has largely been on the part of the public utilities, the steel plants, and the by-product gas producers, many of whom sell their gas directly or indirectly for public consumption. With each of these classes of owners, steadiness of production is highly important; they are large users of specialty forms of coal, frequently of a high grade, and often compete keenly among themselves for the coal of certain preferred varieties found in particular fields. It is significant that the fuel cost is either passed on directly to the customers of this class of users, or is capable of absorption in the manufacture cost. The consequences of the assignment of private cars are more strongly felt in certain localities than in others. On some railroads the question is relatively unimportant. Upon certain divisions of the Pennsylvania, the Louisville & Nashville, and the Chesapeake & Ohio the private cars are a considerable proportion of the whole. It is abundantly made clear from the record that as competition becomes more keen more and more the public utilities, steel producers, manufacturers of by-product gas, automobile manufacturers, certain chemical manufacturers, glass works, and other industries likewise absolutely dependent upon a steady supply of coal, rather than face ruin each recurring coal-car shortage, will be compelled to acquire private cars which they may have assigned. The result is not only an increasing gross inequality between users of this form of equipment who are able to afford the very considerable expense in procuring and maintaining such equipment,

reflected immediately in the disproportion between the amount of their output or consumption as the case may be, but also that the available facilities of the railroad carrier other than cars—locomotives, tracks, and terminals—are taken up in great degree by such classes of preferred users, so that the commercial mines are and will find themselves unable to procure transportation for even the ratable share of the cars which the carrier owns and sets for them. If the practice is continued, it is not too much to expect that in future periods of car shortage due to insufficient motive power, strikes of maintenance-of-equipment employees, and like causes, the scramble for coal on the part of users who can afford to pay the price will lead to the effort to assign privately owned locomotives and train crews privately employed in the manner in which privately owned cars are now assigned. During the car shortage of 1922 we received requests to this effect. . . .

The owners of private cars contend that such cars are essential to insure a regular and adequate supply of coal; that the cars were purchased only after all other remedies had been exhausted and that it was the only method whereby their coal requirements might be met, except by the assignment of cars on order of the Government. It is claimed that the use of private cars during car-shortage periods releases railroad cars for strictly commercial mines, which otherwise would have to be placed at private-car mines. This overlooks the fact that particularly in times of shortage the mine operator is entitled to an equitable rationing of the transportation facilities which are at hand, and that equality is vastly more important to him than a slight addition to his allotment, effectuated by giving his neighbor and competitor a better car supply. Except during car-shortage periods the investment which these owners have made, estimated at approximately $30,000,000 is of no practical utility to them. The mileage allowance paid by the carriers for the use of private cars, which is sufficient when the cars are employed in transportation service, is not adequate compensation for ownership, when there is a car surplus. But the investment was voluntarily made, by persons not common carriers.

Congress has given the coal consumer a right to demand that adequate transportation facilities be provided by the railroad carriers, and has afforded a remedy for the enforcement of that right. We are now prosecuting an inquiry upon our own motion, No. 14489, under the provisions of section 1 of the act, as to the ade-

quacy of the facilities for the performance as common carriers of car service by each of the railroads subject to our jurisdiction, with a view to making an order requiring the respondents to provide themselves with such safe and adequate locomotives and cars as may be warranted by the facts as shown, and as required by law. This power upon our part, and remedy afforded to the shipper, first came into the interstate commerce act as one of the amendments made by the transportation act, 1920. The change in the law differentiates the present case from all those in which the assigned-car rule was developed as prior to February 28, 1920, we had no power to require a carrier to provide itself with reasonable facilities such as equipment, no question of discrimination being involved. *United States* v. *Pennsylvania R. R. Co.*, 242 U. S., 208.

Upon the facts shown of record we find and conclude that in the distribution of cars for transportation of coal among the bituminous coal mines served by the respective respondents, and each of them, whether located upon the line of a respondent or customarily dependent upon it for car supply, any rule, regulation, or practice of the respondents, or any of them, whereby private cars or cars for the loading of bituminous coal for railway-fuel purposes are placed at any such mine in excess of the pro rata allotment and distribution of cars for coal loading currently made to any other of such mines which do not receive private cars or cars for railway fuel and which are on the same division or district established by such respondent for the distribution of cars, is and for the future will be, unjust and unreasonable, and unduly and unreasonably preferential of such mines receiving private cars or cars for railway fuel in excess of such allotment, and unjustly discriminatory against and unduly prejudicial to such other mines not receiving private cars and cars for railway fuel. We further find and conclude that all cars should be distributed by such respondent to all mines on such district or division on a pro rata basis; and that if cars are assigned or consigned to any of such mines, and if they are placed at the mines to which they are assigned or consigned, they should be so placed that every mine on the same division or district should receive the same pro rata share of the total number of available cars, whether assigned, consigned, or unassigned, which are distributed to all mines on such division or district, and that all such assigned or consigned cars should be counted and charged against the mines at which they are placed in the same manner and to the same extent that unassigned cars are counted and charged.

It is not intended that this finding shall preclude the commission hereafter, in proper cases, in the exercise of the emergency powers conferred upon it by paragraph (15) of section 1 of the act, from requiring the placement of cars for bituminous-coal loading at any mine or mines in excess of the current percentage allotment made to mines generally upon the lines of the same carrier, or upon the same division, when the order or direction for placement shall so provide.

There appears to be no reason for the continuance of the investigation as to carriers serving solely anthracite coal mines, and the present investigation, so far as it in terms covers the distribution of cars at anthracite mines, will be discontinued.

We will enter an appropriate order, effective September 1, 1923.[1] . . .

DANIELS, *Commissioner,* dissenting:

I concur in the report so far as it construes paragraph (12) of section 1 of the act.

I am unable to concur in the finding that the present practice of assigning private cars and system or foreign-line cars for railway fuel to bituminous-coal mines is unjust or unreasonable or unduly or unreasonably prejudicial.

My reasons for withholding my concurrence in the report's finding may be summarized as follows: First, the right of a common carrier to obtain fuel for carrier purposes is based on such paramount necessity that the assignment of cars to mines whose entire output is taken by the carrier, even though such assignment of cars disregards a pro rata allotment of open-top equipment among all mines, is not unduly preferential of the carriers or prejudicial to the shippers of commercial coal. Unless the carriers obtain sufficient fuel of the character best suited for effectively moving their locomotives, it is apparent that efficient and economical operation is rendered difficult or impossible. The resort by

[1] The effective date of this order was subsequently postponed, from time to time, pending decision upon petitions for rehearing filed by the carriers. But in *Assigned Cars for Bituminous Coal Mines,* 93 I. C. C. 701 (December 23, 1924), the Commission affirmed its former findings, and set March 1, 1925, as the effective date of the order originally entered on June 13, 1923. On March 12, thirty-five railroads filed a bill in equity in the United States district court at Philadelphia, attacking the order of the Interstate Commerce Commission.

The Commission's order, it was averred, was illegal and arbitrary, since, if allowed to stand, it would seriously hamper operation of the roads by making it difficult to obtain a sufficiency of fuel for their locomotives. Certain coal, coke, and steel companies had previously filed injunction suits for invalidation of the Commission's order.—Ed.

carriers generally to the use of the assigned car would indicate that their experience demonstrates that this system is the most effective, efficient, and economical to attain the end sought. Nor am I persuaded that the abolition of the practice under the present rule will have any other effect comparable with the increased price of fuel to the carriers and a consequent increase in the cost of transportation. I am not persuaded that the abolition of the present practice will appreciably reduce the net cost of mining or moving commercial coal. New England carriers testify that the abolition of the practice will require a doubling of the amount of coal currently stored. Such augumentation of storage will absorb for railway-fuel use an additional number of open-top cars. It will saddle New England carriers with an additional cost per ton for the additional amount of coal they will have to store. It will augment the per diem and car rental. The same or similar effects may be anticipated in all regions of the country. Every additional car absorbed for the supply of railway fuel will lessen to the same degree the number of open-top cars available for general commercial use. It is argued that the abolition of the rule will permit an increase in the working time of commercial mines. The possible increase is, in the first place, not great quantitatively. It may amount to three days per month. There will be a corresponding diminution in the working time of the mines supplied now with assigned cars. The diminished overhead expenses per ton in the first instance will be offset by the increased overhead expenses in the second. Moreover, it must be borne in mind that, except in periods of shortage of open-top equipment, there will still continue a difference in the working days per month between mines which secure large contracts covering their entire output and other mines which are not equally successful in making similar contracts for the disposition of their coal. When it is remembered that, taking a period of 10 or 20 years, the number of months in which there is a shortage of open-top equipment is a very small percentage of the total time, it would appear that the collateral effect of equalizing working time between commercial mines and assigned-car mines in the period of shortage of open-top cars will be in the long run almost negligible. The report properly indicates that the basic difficulty in the coal situation is the overdevelopment of bituminous mines and the vast potential oversupply of current requirements. This fundamental difficulty will persist despite the abolition of the assigned-car rule.

In short, so far as railway fuel is concerned, the assigned-car rule has proved on the whole a workable means of affording an adequate fuel supply of the proper quality and at a low price per ton. The revocation of the rule, in my judgment, will jeopardize the regular supply of dependable railway fuel; it will make for increased locomotive failures by reason of the inability of the carriers to obtain the grade of fuel which is most efficiently employed; it will augument the price of railway fuel without appreciably affecting advantageously the price of commercial coal; and it will render inevitable, in times of emergency, a resort to emergency orders carrying priorities which, in essence, are an admission of the necessity and utility of the present practice.

So far as the supplying of connecting carriers with coal is concerned, many of the considerations outlined above will apply. These connecting carriers on whose lines coal in sufficient amount is not mined now own open-top equipment which they may in part allot to other uses upon their own rails and thereby make an additional draft upon the open-top equipment of the carriers upon whose lines coal mines are located. Such a withdrawal will tend only to lessen the pool of open-top equipment now available for the movement of coal traffic generally.

So far as the so-called private cars are concerned, the situation is slightly different, although I am not persuaded that the abolition of the present practice will result in any advantage to the public generally or to the ordinary shippers of commercial coal. With the violent fluctuations in the coal demand as between periods of intense industrial activity and periods of industrial depression, it is perhaps questionable whether the railroad carriers can be reasonably expected to have ready at all times open-top equipment of their own ownership capable of carrying the peak load. Many private cars have been provided by their owners for just these periods of peak demand. They have thought it wise policy to make the investment to an aggregate amount of something like $30,000,000 rather than to risk their coal supply upon available equipment of carrier ownership or to confront the necessity of having to pay spot prices for coal in a runaway market. The abolition of the present practice limits the availability of these private cars for transportation purposes. For example, a public utility may turn over to a carrier 100 cars for placement at mines where the utility owner has contracted for the entire output. At present all of these cars would be placed at the mine, and, if the

output suffices, they would all be immediately loaded and moved. My understanding is that, under the change in the rule, while these private cars would have to be placed eventually at the designated mine, only the mine's ratable proportion could be moved at a time when there was a general shortage of open-top equipment. If the shortage amounted to 50 per cent, then half of these privately owned cars are required for the time being to stand idle on track and may not be moved except in accordance with the rule that assigns all open-top equipment to all mines in proportion to their respective ratings. How such a withholding of these cars from the work of transportation, even though for a temporary period, can benefit the public generally I am unable to see.

It should also be remembered that the private car under the law as it now stands is not an outlaw. The act contemplates the furnishing of service and of facilities by the owner or the shipper of freight. Section 15, paragraph (13), provides that—

> If the owner of property transported under this Act directly or indirectly renders any service connected with such transportation, or furnishes any instrumentality used therein, the charge and allowance therefor shall be no more than is just and reasonable, and the Commission may, * * * determine what is a reasonable charge as the maximum to be paid by the carrier or carriers for the services so rendered or for the use of the instrumentality so furnished * * *.

Clearly, private cars are an instrumentality.

In our report *In the Matter of Private Cars*, 50 I. C. C., 652, 672, we say:

> An amendment to section 1 of the act, approved May 29, 1917, provides as follows:
> "The Commission shall, after hearing, on a complaint or on its own initiative without complaint, establish reasonable rules, regulations, and practices with respect to car service, including the classification of cars, compensation to be paid for the use of any car not owned by any such common carrier, and the penalties or other sanctions for nonobservance of such rules."
> The Congress has thus recognized the use of privately owned cars in transporting the commerce of the country, and has provided for their control by the Commission through rules and regulations of carriers hauling them.

The warrant for the carriers' use of such an instrumentality is found in the act. For us to make a finding which shall in effect

restrict, or cripple, or prevent the use of such an instrumentality appears to me to defeat the plain expectation of the Congress expressed in the section above quoted. It may even be suggested that such action on our part offends against the constitutional protection thrown about private property. It is urged that private coal cars now absorb a disproportionate share of carriers' power and rails. But the legalized use of instrumentalities furnished by shippers implies the right to use a commensurate share of carrier power and tracks. Some of these private owners of open-top equipment utilize such equipment as a daily necessity in carrying on ordinary industrial operations where a steady supply of coal is absolutely indispensable. Other owners of private cars are public utilities supplying gas, electricity, and local transportation. Where concerns of either character, in reliance upon the lawful use of private equipment, have made substantial investments therein, I question the wisdom as well as the legality of impairing the serviceableness of such equipment by substituting the practice carried by the majority report. In the long run, it will amount to the unsatisfactory substitution of hastily issued emergency and priority orders whose effectiveness will be less than that secured through adherence to the present workable arrangement.

In outlining the above objections to the majority report, I am free to say that many of the abuses connected with or attendant upon the assigned-car rule might be properly controlled and virtually eliminated. I think, however, that the remedy proposed is likely to prove far worse than the difficulties experienced under the present practice. . . .

2. Through Routes and Joint Rates [1]

Harlan, *Chairman:*

The complainant is an incorporated association with a membership composed of merchants and manufacturers of Baltimore. It demands that the Central Railroad Company of New Jersey and certain other carriers shall establish a through route and joint rates for the transportation of freight from Jersey City and New York to Baltimore, by way of Allentown and Gettysburg, in the state of Pennsylvania. It alleges that the defendants have neglected to establish such through route and joint rates in disregard of the obligations in that respect imposed by the act to regulate com-

[1] *Merchants and Manufacturers Association* v. *Central Railroad Company of New Jersey*, 30 I. C. C. 396 (May 11, 1914). See Vanderblue and Burgess, pp. 260–265.

merce. It alleges also that the joint class rates to Baltimore maintained by the defendants from Philadelphia and from Brills, a point in the state of New Jersey just west of Jersey City, are unreasonable and unjustly discriminatory; and the Commission is asked to establish just, reasonable and nondiscriminatory class rates between those points.

From 1895 to 1905 a through route between New York and Baltimore, with joint rates applicable thereto, substantially as now asked to be established, was maintained by certain of the defendants as follows: New York-Allentown, 90 miles, over the Central Railroad of New Jersey; Allentown-Harrisburg, 90 miles, over the Philadelphia & Reading Railway; Harrisburg-Gettysburg, 46 miles, over the Gettysburg & Harrisburg Railway; and Gettysburg-Baltimore, 71 miles, over the Western Maryland Railway; a total distance of 297 miles.

For the greater part of the time since 1898 there have been in effect through routes by direct lines, with joint rates applicable thereto, between New York and Jersey City on the one hand and Baltimore on the other.

These routes vary but slightly in length, and average about 188 miles; the lines over which an additional route is sought are circuitous and the distance is about 110 miles greater. Moreover, the proposed route is not one over which through traffic would be likely to move in any great volume under normal conditions. Generally speaking it would require at least a day longer to move freight under joint rates from New York to Baltimore over such a route than by the direct lines.

The annexed diagram shows the lines of the existing routes, and also the lines of the proposed route through Allentown and Gettysburg. It is to be observed that the Central Railroad of New Jersey, the principal respondent, gets much shorter hauls under the routes to which it is already a party than the haul it would get under the proposed route if established; and if it had not joined in routes and rates over the direct lines, a question might have arisen whether it could be compelled to do so. The statute declares that the Commission shall not require any carrier without its consent to embrace in a through route substantially less than the entire length of its line between the termini of such route, unless to embrace the entire length of its line would make such route "unreasonably long" as compared with some other practicable through route. But the Central of New Jersey, by voluntarily joining in two direct routes,

has embraced very much less than the entire length of its line between New York and Baltimore; and in its answer to the complaint, it explains that the reason it does not publish joint rates through Allentown and Gettysburg is because the public interests would not be subserved by such a route. It avers that shippers are best served by joint rates over the direct lines; and it denies that there is any public demand for the additional route demanded

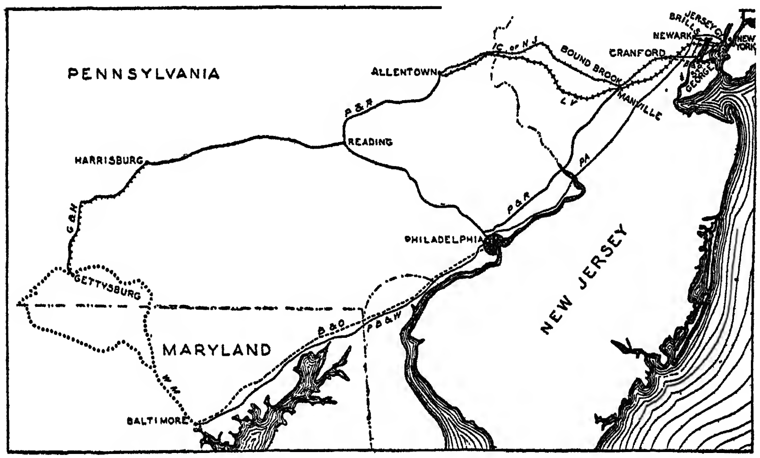


PLATE 16.—Routes between New York and Baltimore.

by the complainant. Most of the other defendants refer to and adopt the answer of the Central of New Jersey.

The Western Maryland has filed no answer. A witness for that company testified that when the lines through Gettysburg were operated as a through route with joint rates it was customary to give second or third morning delivery on New York traffic at Baltimore, and the same delivery on Philadelphia traffic. He said he knew of no good reason why the old route and joint rates should not be reestablished. The direct lines ordinarily make delivery of New York traffic at Baltimore on the first morning after shipment.

The complainant's contention for an additional through route and joint rates is based chiefly upon an alleged lack of facilities for handling package freight through the stations of the Baltimore & Ohio and Pennsylvania lines at Baltimore. It is insisted that if the proposed route and joint rates were established the stations of the Western Maryland at Baltimore would be brought into service and additional terminal facilities would thus be provided. There is

nothing of record to show, however, that any considerable volume of freight that now moves over the direct lines would be diverted to such circuitous route.

The complainant's evidence is to the effect that for three or four months following September 1, 1913, there was some congestion of traffic at the Baltimore & Ohio and Pennsylvania terminals in Baltimore. It seems, however, that the probable cause of this congestion was the withdrawal by those lines on the date named of the so-called store-door delivery service which had theretofore been maintained by them for many years, and which embraced, with a few exceptions, the first three classes of freight.[1] Baltimore merchants, within certain prescribed limits, had become accustomed to have their package freight delivered at their store doors; and the sudden withdrawal of the service naturally produced confusion and resulted in delays which for a few months were of a serious nature. The situation had greatly improved, however, at the time of the hearing of this case, though it was said that deliveries were not yet as promptly made as under the former service. As the merchants are becoming accustomed to the changed conditions, congestion is less marked and delays are less frequent; and there is nothing in the record seriously to suggest that the congestion may not be entirely eliminated within a reasonable time under improved terminal facilities and proper warehousing rules. There is no reason why congestion or confusion should result from deliveries, at adequately equipped stations or warehouses, to drays belonging to or employed by the merchants, any more than from deliveries to drays employed by the railroads.

Whether future congestion would be prevented by an additional route and joint rates over circuitous lines is entirely conjectural. Several witnesses for the complainant expressed the view that the situation would be improved; but the sole basis of that view was that with the new route the terminals of the Western Maryland would be made available for handling freight. It was said that under the former through route and joint rates the Western Maryland for a time carried daily about 50,000 pounds of package freight westbound, and from 20,000 to 30,000 pounds eastbound; but this was at the time of the great Baltimore fire of 1904 when the terminals of the other roads were in disorder. From the evidence of record we are not convinced that an additional route with joint

[1] See Vanderblue and Burgess, pp. 216, 218; and *Washington, D. C., Store-Door Delivery*, 27 I. C. C. 347.—Ed.

rates over the circuitous lines would insure the handling of any considerable volume of freight through the Western Maryland terminals at Baltimore.

There is a through-car service for merchandise freight from New York to Baltimore over one or more of the direct routes, and the cars move in through trains. It is not seriously contended that such a service could be successfully maintained through Gettysburg, nor does the record suggest that there would be sufficient traffic to justify an effort to that end.

It was testified by the traffic manager of the complainant that this proceeding is the outgrowth of the discontinuance of the store-door delivery. He stated that in the investigation of that matter it was discovered that a former route through Gettysburg had been closed to traffic from New York, and it was then decided to ask that such route be reestablished. It does not appear that there was any congestion of traffic at the stations in Baltimore prior to September 1, 1913, or that Baltimore merchants were subjected to inconvenience by the closing of the Gettysburg route in 1905.

The Baltimore & Ohio and Pennsylvania roads are responsible for the condition of their terminals at Baltimore, and if their terminals are not sufficient to insure the prompt delivery of traffic they should be made so. It is not contended that the service under the existing through routes and joint rates is otherwise inefficient.

It is well settled that even though through routes and joint rates may exist between two points, this Commission has the authority to establish additional routes and to prescribe just and reasonable joint rates to be applied thereto. But the grant of this authority contemplates the exercise of judgment upon the facts disclosed. . . .

Upon the evidence of record, . . . the question is whether the public interests require a through route with joint rates between New York and Baltimore, over the circuitous lines referred to, in addition to the several existing through routes over the direct lines. In our judgment this question must be answered in the negative. The prayer of the complaint in this respect must be denied. . . .

The class rates between Philadelphia and Baltimore through Gettysburg are somewhat higher than the class rates over the direct lines, but they are not shown to be higher than rates generally in effect for similar distances in other parts of the same territory. On the contrary, they are in some instances lower than the

class rates maintained by respondents for similar distances to interior points unaffected by water competition. The distance by the direct lines is 95 miles, whereas the distance through Gettysburg is 229 miles. The record presents no good reason why the circuitous lines should be required, against their consent, to establish and maintain the same rates as the direct lines. The evidence does not show the existing rates to be unreasonable, or that their effect is to subject the complainant's members to unjust discrimination.

It follows from our findings that the complaint must be dismissed, and it will be so ordered.

3. Abandonment of Service

A. General Principles [1]

The jurisdiction of the Interstate Commerce Commission over railroad abandonment is that:

> "No carrier by railroad subject to this Act shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment. . . . From and after issuance of such certificate, and not before, the carrier by railroad may, without securing approval other than such certificate, comply with the terms and conditions contained in or attached to the issuance of such certificate and proceed with the . . . abandonment covered thereby." [2]

In 1921 the Commission authorized the abandonment of 701.94 miles of railroad, in 1922 of 526.53 miles, and in 1923 of 523.41 miles. The greater part of this mileage was of short lines and branches, the longest single line of which abandonment was permitted being that of the entire line of 234.3 miles of the Chicago, Peoria & St. Louis Railroad in Illinois. While the application was vigorously opposed by representatives of communities and shippers along the line of road, the Commission acted upon a showing by the receivers under the mortgage foreclosure that the road had been piling up deficits for many years and that they were no longer able to finance its operation. A state court which had appointed

[1] From Kenneth F. Burgess, "Federal Regulation of Railway Management and Finance," *Harvard Law Review*, vol. 37, pp. 716–720 (April, 1924). Reproduced by permission. See Vanderblue and Burgess, pp. 299–303, and Jones, p. 558.

[2] See Sec. 1, pars. 18, 20, 41 Stat. at L. 477, 478.

the receivers had directed them to make application to the Commission for a certificate authorizing abandonment. As a part of its reorganization after a receivership, the Chicago & Eastern Illinois was likewise authorized to abandon a branch line in Indiana 162 miles in length. The Commission acted upon a showing of unprofitable operation, the omission of the branch under the reorganization plan, and the unwillingness of the bondholders to furnish equipment. The operation of a part of this road was subsequently undertaken by a new corporation.

It was early held that a clear case of necessity and public advantage must be made out before a certificate would be issued. Mere inability to operate a branch line at a profit was held insufficient justification, where the carrier was making a return from its operations as a whole. Neither would abandonment be authorized for the purpose of effecting a saving in cost of operation where the public served locally would have to pay higher freight charges via other routes. But where it was established that an entire line which it was sought to abandon had failed to earn enough to pay the expense of running its trains, the Commission held this to be "cogent evidence that public convenience and necessity does not require it to be kept in operation." While, prior to the enactment of this statute, the courts had frequently enjoined interference with railroad abandonment, they can now, so far as interstate operation is concerned, act only after determination by the Commission upon an application for a certificate.[1]

On a showing of loss from operation and potential saving through abandonment of a part of a main line paralleling the main line of a competing railroad, the Commission authorized abandonment over the objection of small communities local to the line which was to be abandoned. The applicant here had made arrangements for a joint user of the remaining main line of the competitive carrier, and the Commission found

"that the construction of two parallel railroads . . . was a wasteful duplication of transportation facilities; that the joint operation of one line, wherever possible, would adequately serve the transportation requirements, and that the economies resulting therefrom would ultimately inure to the benefit of the territory traversed as a whole." [2]

[1] Abandonment has been permitted by the federal courts over the protests of state authorities where past losses coupled with no reasonable prospect of future profit have been established. *Brooks-Scanlon Co.* v. *Railroad Comm. of La.*, 215 U. S. 396 (1920); *Bullock* v. *R. R. Comm. of Fla.*, 254 U. S. 513 (1921). . . .

[2] *Abandonment of Part of Line by Oregon Trunk Ry.*, 72 I. C. C. 679, 683 (1922).

The primary test, therefore, which the Commission has applied under this authority is the financial ability to continue operations. Where an entire railroad has made proof of the same facts which would have entitled to relief in the courts prior to 1920, the Commission has authorized abandonment. In dealing with branch lines, the Commission in some instances has denied relief even on a showing of financial loss, where the burden upon the system as a whole was not great. The gain by the new legislation appears to have been merely the transferring of primary jurisdiction from the courts to an administrative body.

In one respect at least this has resulted in delay and a circumlocution of action. The courts originally exercised a jurisdiction over the entire abandonment of a railroad property, without regard to the intrastate or interstate character of the operations, protecting property rights under the Fifth or Fourteenth Amendment. But the primary jurisdiction of the Interstate Commerce Commission is only in respect to interstate operations and it can authorize total abandonments only on a finding that continued intrastate operation will burden interstate commerce.[1] As a practical matter, a railroad which ceases to operate in interstate commerce can rarely, if ever, continue its intrastate operations at a profit, and it may then resort to the courts in its abandonment of its intrastate operations for protection against the confiscation of its property. But this involves both delay and a multiplicity of actions.

B. ABANDONMENT OF AN UNPROFITABLE RAILROAD [2]

BY DIVISION 4:

The Chicago, Peoria & St. Louis Railroad Company, a carrier by railroad subject to the interstate commerce act, hereinafter

[1] In an early case, *Certificate for E. Texas R. R. Co.*, 65. I. C. C. 436 (1920), the Commission authorized physical abandonment and dismantling of an entire line of railroad within the state of Texas. The Supreme Court, however, set aside this order in so far as it authorized physical dismantling and abandonment in respect to intrastate operations, in the absence of a finding by the Commission that continued operation in intrastate commerce would be a burden upon interstate commerce. *Texas* v. *E. Texas R. R. Co.*, 258 U. S. 204 (1922). Subsequent to this decision the Commission authorized only the abandonment of interstate operations except where the burden of continuing interstate operations at a loss would be reflected in the accounts of an interstate carrier, in which event abandonment as to both interstate and intrastate operations has been authorized. *Abandonment of Line by Colo. & S. Ry.*, 82 I. C. C. 310 (1923), affirmed on rehearing, Feb. 11, 1924, 86 I. C. C. 393. . . .

[2] *Abandonment of Chicago, Peoria & St. Louis R. R.*, 76 I. C. C. 801 (March 19, 1923). The map (Plate 17) is reproduced, by permission, from the *Railway Age*.—Ed.

called the Chicago Company, and Bluford Wilson and William Cotter, as receivers thereof, on December 18, 1922, filed a joint application, pursuant to paragraph (18) of section 1 of the interstate commerce act, for a certificate that the present and future public convenience and necessity permit the abandonment of the railroad of said company. . . .

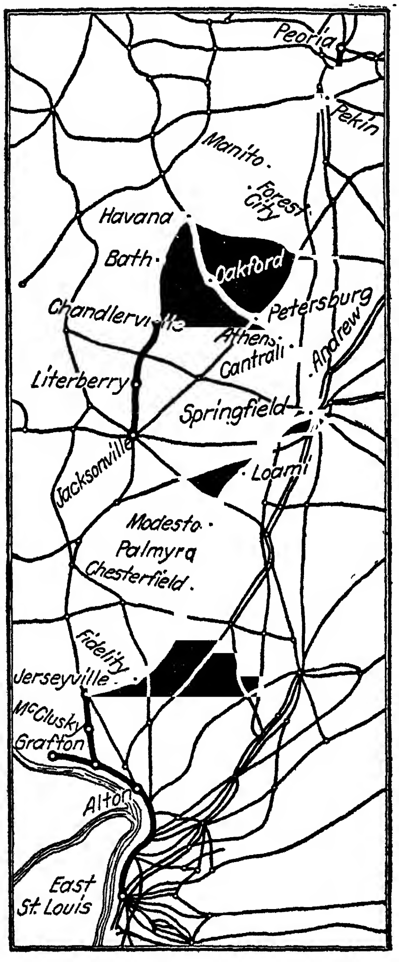


Plate 17.—The Chicago, Peoria & St. Louis Railroad.

The Chicago Company was incorporated on November 29, 1909, under the laws of Illinois, and on January 1, 1913, acquired the property of the Chicago, Peoria & St. Louis Railway Company at foreclosure sale. On July 31, 1914, it was placed in the hands of Bluford Wilson and William Cotter, as receivers, by the Circuit Court of Sangamon County, at the suit of the Bankers Trust Company, trustee under its general and refunding mortgage. The receivers operated the railroad until January 1, 1918, when it was taken possession of by the United States and remained under Federal control until March 1, 1920, on which date it was returned to the receivers. July 1, 1920, the Equitable Trust Company of New York, trustee under a prior-lien mortgage executed by a predecessor company, filed a bill to foreclose in the same court, and on that date Bluford Wilson and William Cotter were also appointed receivers in said proceeding and directed to turn over to themselves as such receivers all property theretofore in their possession under the order of July 31, 1914.

The receivers have since continued in possession of and have operated the railroad.

On October 20, 1922, a committee of prior-lien bondholders, appointed pursuant to a bondholders' protective agreement, requested the receivers to forthwith take the necessary proceedings to procure the discontinuance of operation of the railroad. On the same day a committee representing the general and refunding mortgage bondholders joined in the above request, reserving the right to question the priority of certain liens. Thereupon the receivers applied to the court for instructions, and on December 9, 1922, the court entered an order directing the receivers to make application to us and to any other commission or governmental body deemed by the receivers to have jurisdiction for leave to abandon operation of the railroad. This order recited that it appeared to the court that it is impossible for the receivers to operate said railroad and property except with continuing losses and accumulating deficits.

The country traversed, with the exception of 15 miles south from Havana on the Jacksonville branch and approximately 10 miles south from that point on the main line, and for a distance of 15 miles between Hettick and Medora on the main line, is a part of the richest agricultural territory in Illinois. This railroad serves 35 cities and incorporated villages, 20 of which have no other rail-transportation facilities. The straight-line distances from the latter points to another railroad range from 1.5 to 13.8 miles, the average distance being 6.66 miles. The intervening highways, with few exceptions, are in fair condition. The populations of the towns and villages that would be deprived of rail service through the proposed abandonment range from 120 to 1,050. The total population in the territory served is estimated by the applicants at 372,241. Three coal mines, 43 grain elevators, and 3 manufacturing plants are located at points not served by another railroad. At competitive points, 10 grain elevators, 18 industries, and 2 coal mines are located solely on the tracks of this railroad. The line connects with 38 railroads, including terminal lines, for interchange of traffic, at 68 points. In the East St. Louis district 19 of these connections are made through interchange by the Terminal Railroad. It also connects at East St. Louis with the Wiggins Ferry. The distances between competitive points are materially greater by this line than by other railroads. Manufacturing industries of importance are located at points served by other railroads.

On behalf of the applicants it is represented that from March 1, 1920, to June 30, 1922, the average annual operating deficit, before bond interest or interest on receivers' certificates, was $605,000, and that if adequate charges for maintenance and depreciation had been made the operating deficit would have averaged $832,000 per annum; that the taxes for 1921, approximating $120,000, are unpaid, and that threats have been made by the taxing authorities to sell the property; that large penalties are accruing because of default in paying taxes; and that the taxes for 1922 will be due shortly and no funds are available to pay them. It is claimed that the receivers have been able to operate the railroad thus far by the omission of proper maintenance, depletion of capital assets, and indulgence of creditors, and that they can not procure credit for further operation. From time to time traffic balances have been pledged to secure bank loans to meet pay rolls. Large amounts are owing for coal, and it is stated that if the coal companies refuse further credit it will be necessary to discontinue operations within two or three days thereafter, as no surplus fuel is on hand. Receivers' certificates to the amount of $295,000 are outstanding, of which $230,000 are past due and unpaid. Authority has been granted the receivers to sell additional certificates to the amount of $335,000, but it is claimed that they have been unable to dispose of them after diligent effort. It is stated that the Government lost $1,900,000 in operating the line during the Federal control period.

The general balance sheet of the Chicago Company and its receivers as of October 31, 1922, showed capital stock, $4,000,000; funded debt unmatured, $4,122,000; current liabilities, $2,666,-974.26; unadjusted credits, $909,360.15; investment in road and equipment, $8,271,566.80; investments in affiliated companies, $350,000; other investments, $13,100; current assets, $580,939.29; unadjusted debits, $433,010.30; profit and loss debit balance, $2,049,927.82. Interest on the prior-lien bonds to the amount of $450,000 is due and unpaid, while the interest on the general and refunding bonds has been in default since 1914.

For the period beginning January 1, 1917, and ending October 31, 1922, the results of operation were as follows: Operating revenues, $12,685,246.24; operating expenses, $14,529,747.63; deficit in net railway operating income, $2,966,152.10. The net operating revenues for the first 10 months of 1922 showed a deficit of $62,-854.29, as compared with a deficit of $272,216.19 for the corresponding period of 1921. It is stated that the apparent im-

provement in operating results in 1922 is due almost entirely to undermaintenance caused by financial inability to make adequate repairs for efficient operation. The losses from operation in November and December, 1922, were $28,000 and $26,000, respectively. The total tonnage handled decreased from 2,410,207 tons in 1917 to 1,289,707 tons in 1921. The chief commodities transported were bituminous coal, agricultural products, and clay, gravel, sand, and stone. Passenger revenues for the five-year period beginning January 1, 1917, totaled $1,494,167.02. A number of reasons are assigned by the applicants for the decrease in traffic. It is claimed that soliciting agencies maintained by the Chicago Company at four large traffic-producing centers foreign to its line were discontinued during the Federal control period, and that a large freight tonnage that was being received as a result of years of solicitation was lost through short routing. The applicants represent that the railroad was turned back to the receivers at the end of Federal control in poor physical condition, and that the receivers were unable to open outside agencies because it was necessary to devote the small available financial resources toward making the railroad safe for operation. Within the last year a concrete road has been completed between East St. Louis, Springfield, and Peoria substantially paralleling the entire length of the main line. Both passenger and freight revenues have suffered from automobile competition. Considerable business has been lost by shortage of motive power and inability to furnish cars at competitive points, particularly East St. Louis and Peoria, where unrouted freight is delivered to carriers able to handle it. Of 1,701 freight cars owned, 840 are in bad order, and 20 out of a total of 51 locomotives are out of service, awaiting heavy repairs. It appears that for a number of years the Chicago Company has been unable to devote sufficient sums to maintenance. As a result the road and equipment are in poor physical condition. No funds are available to improve them or to maintain them in their present condition, and the credit of the receivers is exhausted. Inadequate maintenance has impaired the ability of the line to perform transportation service and has made it necessary to restrict the speed of trains, resulting in a large increase in the cost of operation. It is represented that operation of the line will soon become dangerous unless substantial sums are made immediately available for maintenance. The testimony shows that it would cost $1,750,000 to rehabilitate the railroad, without including anything for working

capital. The vice president of the Chicago Company, who is also general manager for the receivers, testified that if the line were rehabilitated and financed entirely by capital stock it would require an increase of over 100 per cent in local traffic to pay operating expenses. It is represented that engineers employed by the prior-lien bondholders' committee reported that in their judgment the railroad, if rehabilitated by the expenditure of an amount necessary to put it in good operating condition, would not be able to earn a return even on the rehabilitation cost.

This railroad is located in a highly competitive territory and it is claimed by the receivers that increased divisions on freight, on which the road secures an intermediate haul, and on business destined to and originating on the line at competitive points, would result in greater loss than gain because connecting lines would solicit against the Chicago Company's line. On business originating and received at noncompetitive stations, which originates at or is destined to stations on other lines, the divisions now received exceed a mileage prorate and for the year ending October 31, 1922, amounted to $401,498.84. It is claimed that this is the only traffic on which additional income could be secured through increased divisions, but as the net operating loss for the same period was $587,123.32, it is asserted that any increased divisions would not furnish sufficient revenue to enable the receivers to continue operation.

On the part of the protestants testimony was offered tending to show that there would be a large decrease in real-estate values through the proposed abandonment, the figures submitted totaling more than $8,000,000. Depreciation in values of farm lands is estimated from 10 to 30 per cent. It is pointed out that some shippers at competitive points would be placed at a disadvantage because their industries are located solely on sidetracks of the Chicago Company, and that several towns would be left without railroad service.

There are 17 trunk-line railroads which connect directly with this line and 7 others which connect via the Terminal Railroad at East St. Louis. The vice president of the Chicago Company testified that those portions of the line from Pekin to Manito, 11.9 miles; Petersburg to Waverly, 45.2 miles; Grafton to East St. Louis, 35.4 miles, as well as some industry tracks at competitive points, might be acquired and operated by connecting lines or industries. Along these portions of the line there are 16 industrial

plants, 16 grain elevators, and 5 coal mines which are located exclusively on the tracks of the Chicago Company. The industries on the line between Grafton and East St. Louis furnish the greater part of the tonnage in manufactured products.

The burden of establishing a case which will justify us in finding that the public convenience and necessity permit of the abandonment of a line of railway or the operation thereof rests upon the applicant. The present record establishes that the receivers can no longer operate the line as an independent unit. Long-continued deficits in railway operating income, with resultant undermaintenance, render further operation by the receivers unsafe and impracticable, and maintainable only by further dissipation of capital resources. It may be that the line or parts thereof could, under certain circumstances, become self-sustaining. Possibly the line as a whole could be operated to some advantage by a connecting trunk line, but, so far as the record shows, no connecting trunk line has shown any interest in acquiring the line. As stated above, one of the witnesses appearing on behalf of the applicant testified that sections of the line might be acquired and operated to advantage by connecting lines or industries, pointing to the conclusion that other sections of the line can no longer be operated by any one and should be abandoned. Whether or not any particular section of the line can be operated successfully can not be determined definitely except after trial. It is therefore impossible for us to determine with respect to any particular section of the line whether it should be abandoned or continued in operation. The record justifies the finding that the operation of the line as a whole may be abandoned. Nothing herein decided will preclude the continued operation or the restoration to operation of any sections of the line which, it may subsequently develop, may be successfully operated.

It is assumed that the court having jurisdiction of the receivership will require the receivers to first offer the entire railroad for sale for continued operation, and that if no satisfactory bid on this basis is received, to offer the road for sale in sections for continued operation; and if no satisfactory bid is received for any section or sections to then offer such remaining section or sections for sale as scrap or junk. Reasonable publicity should be given the above offer or offers in the territory to be affected. At connecting points shippers or connecting carriers should be given opportunity to purchase the tracks and terminal facilities. This procedure will

doubtless save for operation such sections of the line as may be practically operated. The future success of such sections will be dependent in large measure upon the support of the people to be served, especially those who may be entirely dependent upon said sections for transportation. They should realize that they have a duty to perform. The mere desire to have a railroad is not enough. There must exist the will to cooperate in its operation by accepting such reasonable economies in service as may be feasible, and by adequately supporting the line. Resort should not be had, where no necessity exists, to other carriers or to other forms of transportation.

Upon the facts presented we find that the present and future public convenience and necessity permit the abandonment of operation, as to interstate and foreign commerce, of the line of railroad in question. A certificate to that effect will be issued accordingly.

CHAPTER XV

RAILROAD TERMINALS [1]

1. Railway Service and Regulation in Port Terminals [2]

The regulation of transportation in the United States has been the outgrowth of a theory which has demanded competition among common carriers. Our early railroads were short and disconnected lines and the regulation, if any, was local in character. As these roads lengthened out into systems many difficult problems presented themselves and the relation of common carriers to industries took on a new significance. This was not appreciated for some time and the carriers in this country were left without adequate control for more than half a century. Even at the present time our legislation does not recognize sufficiently the fundamental principles of economics which should be applied to the transportation business. Our theory of railroad control in this country has apparently assumed that carriers and industries belong to the same class. The principles of economics which might apply to certain industries have been carried over into railway regulation, and it has been impossible, therefore, for carriers to render the kind of service which the public has a right to expect. Nor will carriers render the service which they should until legislation forces them to do certain things they will not do under present railway legislation.

In this country as compared with European countries we had little regulation of railway building. For many years railroads were built parallel to each other; in some instances, merely to force the original road to buy out the newcomer in order to prevent rate wars. In France, on the other hand, the regulation of railway building was of such character that railroads were planned by engineers under direction of the French government. Generally speaking, the roads there radiate out from Paris like the spokes in a wheel. The ambitious promoter of railroads did not find a fertile field in France. In this country, in addition to much parallel

[1] See Vanderblue and Burgess, pp. 272–281.

[2] From C. O. Ruggles, *American Economic Review*, vol. 11, pp. 438–446 (September, 1921). Reproduced by permission.

building, certain roads secured most of the valuable land suitable for terminal transportation and it has been difficult for late comers in our important terminals to render efficient service to the public.

The lack of regulation of railroad building in America has had some very unfortunate results. It resulted in excess of railroad mileage over needs throughout many portions of the country and it brought monopoly control of terminal facilities. Charles Francis Adams pointed out in 1875 that in this country railroads were built out into sections where nobody lived and from that point on out to where nobody cared to go. The excess of transportation facilities continued until about 1905 and it meant keen competition among roads. Our parallel mileage has meant more discrimination on the part of carriers in favor of or against industries than has been the case in other countries. Moreover, it has meant that terminal facilities over which certain roads have had monopoly control have been used to secure traffic that could not otherwise be obtained. It is evident, therefore, that one of the most vital phases of railway regulation for the future is that of the control of transportation service within our important port terminals and in a proper coördination of rail and ocean transportation.

The difficulties now encountered in rendering efficient transportation service in our port terminals may be attributed to three groups of causes: (1) those which concern railroads primarily; (2) those that result from the practice of certain industries; and (3) those due to the lack of foresight on the part of governing authorities in providing for the coördination of all terminal transportation services and facilities.

The traffic which enters important ports is of two kinds: first, traffic destined for points beyond the port, and, second, that for distribution within the port terminal itself. It will not be possible to prevent the clogging of our transportation machinery and the necessity for embargoes upon freight when traffic becomes heavy, so long as all the carriers within our port terminals are permitted to handle traffic in the interest of the individual systems concerned. Railroad control of strategic terminal facilities in our ports has been the natural outcome of competition among our railroads, but it has had some very unfortunate results.

In the first place, government control over railroad rates has intensified railroad competition in terminals; railroads have vied with each other in offering ample terminal facilities and this practice has resulted in duplication of expensive terminals without

adequate provision for their physical coördination. Such a policy has meant the purchasing of much terminal land or water frontage by the railroads in anticipation of their needs. Thus we have railroad domination of the New Jersey side of New York Harbor. Some of the unfortunate results of this situation were indicated in the evidence presented to the Interstate Commerce Commission in the notable New York Harbor case.[1] It was pointed out in the decision in this case that railroad rivalry had prevented the establishment of reciprocal switching arrangements and a joint terminal operation of railway facilities on the New Jersey Shore. In other words, the lack of a program of unification of facilities has caused carriers to invest large sums in new terminals for their individual use instead of uniting in a common effort to solve in a larger way the terminal problems of our ports. At only a few ports in this country have such unsatisfactory conditions been prevented. New Orleans and San Francisco are conspicuous exceptions to the general rule. Examination of the dockage and wharfage charges at the various ports in this country indicates that in some instances terminal charges are in addition to the line haul and in other cases are absorbed. Ordinarily these charges are absorbed on traffic coming from competitive territory or in cases in which the railroad receives a certain minimum revenue.

The second unsatisfactory result of railroad competition in our terminals and ports has been the rendering of services in terminals for less than cost. This has been done in order to secure the line haul of the traffic. Testimony was given before the Interstate Commerce Commission in 1912 to the effect that lighterage and other terminal services in New York cost the Baltimore and Ohio Railroad more than the allowance it received for those services out of joint rates; that on this account that railroad had a deficit on its terminal services in New York, for the years 1909–1911, of more than one and one quarter million dollars. In the decision of the so-called Five Per Cent case, the Interstate Commerce Commission said there were many special services being rendered by carriers to shippers for which no special charge or a non-compensatory charge was being made. The commission stated that the compilations prepared by it from carriers' answers to its inquiries showed that the practice of individual roads meant the absorption of enormous expenses by carriers for such terminal services as loading and unloading carload freight, allowing for free time for

[1] 47 I. C. C. 643 [Below, pp. 344–351].—Ed.

loading and unloading, collecting and delivering freight, storing freight, furnishing and transporting dunnage, furnishing or paying for wharfage and dockage and other special services.

The third unsatisfactory result of competition in furnishing terminal and port facilities by a number of different railroads is lack of coördination both among the railroads and between rail and water carriers. A common provision in terminal tariffs is to the effect that a railroad does not obligate itself to furnish wharfage, storage, or handling of freight which has not been transported or is not intended to be transported over its line; but that it reserves the absolute right to the use of its piers or docks. In response to an inquiry concerning wharfage rates in New York Harbor for the United States Shipping Board the reply was given by a number of railroads that they quoted no wharfage rates on their piers, for to do so would be to give the impression that they were open to public use, which they said was not desired. In actual practice, such theories frequently mean the refusal of one railroad to permit the use of its terminal facilities by other roads unless it receives the line haul of the traffic. From the land end of transportation it is the switching service which must be depended upon to unify the port in the movement of cars from one waterfront to another with the least possible delay. But, as a matter of fact, there is often much delay and sometimes refusal on the part of carriers in rendering switching service for each other. What this means at Boston, for example, may be seen from the *Second Annual Report of the Commission on Waterways and Public Lands*, in which it is stated that the time limits are marked by the "number of days involved rather than hours," and where "charges are several times as large as those made under better organized conditions." The President of the Port of Seattle, before the American Association of Port Authorities in 1917, pointed out that at the time, the Northern Pacific switching tracks on Seattle's marginal streets were divided into "thirteen districts or zones each having a switching rate ranging from $1.50 to $12."

The refusal of a railroad to do switching when import or export freight is involved means inefficiency of both rail and water transportation. For example, if railroad *A* refuses to accept freight in switch movement from railroad *B* when it is to be exported from the piers of railroad *A*, this means that railroad *B* is compelled to lighter the cargo to the vessel at the pier of railroad *A* or the vessel must shift to the piers of railroad *B* after taking

on its cargoes at the piers of railroad *A*. Likewise, if part of the cargo of the vessel is destined to points not located on the line of the railroad at whose piers the vessel docks, this cargo must be lightered to the piers of the railroad over which it is to be carried or the vessel must shift in order to discharge the cargo at the piers of the road which is to have the line haul. Such a practice makes as many separate ports within a port as there are deep water terminals controlled by the different railroad companies. It sometimes means too that there is congestion at the water terminals of some railroads while others are not used to their capacity. This inefficiency in terminal services, which means imperfect coördination of rail and water carriers, makes embargoes upon traffic necessary. The effects of these embargoes extend far into the interior. Obviously the restriction of strategic port terminal facilities to its own use is an attempt by the railroad to secure a line haul of the traffic. While this is a failure to appreciate that railroads are common carriers, it is, as has been said, the logical result of railway competition in the furnishing and in the operation of terminal facilities.

The second group of causes which are responsible for the inefficiency in our port terminals relates to the fact that industries now occupy certain locations which should be devoted to transportation services only. There are two important functions which ports, for example, must serve, industrial and commercial. Generally speaking, the industrial function is the use of the port in serving local needs, whereas the commercial function involves the use of the port as an essential link in commerce. Frequently the two uses are confused and there is inefficiency in both. The industrial use of the port through the appropriation of deep waterfront is an old and common practice in American ports. Industries have had great difficulty in securing efficient railway service within ports and hence they have frequently secured a location on the waterfront itself where they might be able to avail themselves of lighterage services and to gain a more direct connection with ocean carriers, thus making themselves practically independent of rail transportation. Every port has a right to develop industrially. It is in the interest of society that it should; for it is frequently there that greatest efficiency in industrial processes can be obtained. Statistics of manufactures show that this fact is recognized. Rail carriers are interested in transporting raw material away from the port to some point in the interior where it is manu-

factured and returned to the port for export or distribution within the country, thus giving the railroad a haul in both directions. But has any port the right to develop industries on its waterfront in such manner as to interfere with the function of the port as a link in the chain of world commerce? Ocean-going vessels can be accommodated only at the deep waterfront. Industries, on the other hand, can be served back some distance from the waterfront if efficient rail service is provided. In New York Harbor at the present time the dockage facilities on the Manhattan side of the North River are being used by vessels that could be accommodated in the East River or elsewhere. There are vessels now using the waterfront of the North River that draw no more than 17 feet of water and they are occupying berthage space which ought to be available to ocean-going vessels that draw 35 feet of water. It is interesting to observe that the Director of the Port of New York recommended in November, 1918, the shifting of the Sound steamers to the East River. In making this recommendation he pointed out that, in addition to providing greater accommodation for ocean-going vessels, such a change would eliminate the trip of the Sound steamers around the Battery, saving sixty miles of useless navigation per day and relieving much of the congestion at that point; also that if the freight carried by the Sound steamers were discharged in the East River it would greatly relieve congestion from drayage in certain parts of Manhattan and make effective use of streets which at present are used much under capacity. It is evident that the Sound steamers use North River because it means cheaper service and greater convenience for certain industrial interests in lower Manhattan. The fourth preliminary report on the port of New York by the New Jersey Harbor Commission contains evidence showing that certain sections of New York Harbor frequently have become congested while other portions with great commercial possibilities have remained undeveloped; that private interests have acquired by purchase or lease the best localities in the harbor and, in the absence of any general authority, have planned their terminals for individual needs, which were often not for the benefit of the port as a whole. In contrast to the policy in the port of New York, New Orleans has complete control over her waterfront. It is true that the Illinois Central Railroad now holds a portion of the waterfront at that port, but this can be taken away from it at any time the port authorities of New Orleans deem such action to be in the

interest of the port. In the improvement which is now going on in New Orleans attempt is being made to reserve the deep waterfront of that port for commercial uses. New Orleans is now preparing industrial sites and constructing canals which will enable industries although located some distance from the waterfront to use lighterage services in the making or receiving of deliveries. New Orleans, San Francisco, and some other Pacific ports have made much headway in preventing the conflict of the industrial and commercial uses of a port.

The third group of causes of inefficiency in our ports has been due to the lack of foresight on the part of governing authorities in securing the coördination of transportation services within our port terminals. It was natural that industries and railroads should have been given what they asked in the early history of port development. Hence railroads and industries secured control, many times through actual ownership, of much deep water frontage which never should have been surrendered to them. Railroad maps of many of our important ports show clearly that railroads not only attempted to secure exclusive control over deep water frontage but that they located their lines in such manner as to make it impossible for other railroads to secure waterfront privileges without consent of the road already located in the port. It is strange that cities have not appreciated that it is to their interest to secure the actual ownership of waterfronts and to control them in such manner as to prevent inefficiency of transportation within their harbors. But even in cases where the cities have secured the ownership of their waterfront they have not always taken advantage of their opportunities. For example, New York owns most of its waterfront but has been following the policy of granting long-time leases, which has resulted in loss of control of the water frontage as definitely as if that city had resold its water frontage to individual interests. Charges and services have not been controlled by the city but have been determined by private interests that have held the long-time leases. Cities have found it profitable to lease their waterfront because it has meant a definite amount of revenue for the city treasury. But the question may be asked whether cities should be permitted to use their waterfront as a revenue producing facility, and so cause expense and inconvenience to the country at large. For example, would it not be as logical to permit New York City to retain the customs duties collected at that port upon the commerce of the United

States as it is to permit a use of the harbor which produces revenue for the city treasury at the expense of the country's commerce.

What remedy can be found for the present inefficiency of transportation service in our port terminals? Some authorities have held that our present difficulties are due to certain features of past railway legislation and that with the repeal of that legislation nothing more is necessary. But it does not appear that repeal of legislation prohibiting certain railway combinations is sufficient. It is not reasonable to expect (human nature being the same in the railroad as in other businesses) that the railroad which enjoys a strategic position in a terminal will voluntarily give up its monopoly advantages by granting to other roads privileges which will mean the dividing of profits with those roads. Hence railroads in important port terminals must, apparently, be required to relinquish their rights to individual ownership of railroad facilities in such terminals. This would not necessarily mean government ownership or government operation of terminal facilities. Separate terminal companies could be organized that would have no more interest in the business of one carrier than in that of another.

If the control of all terminal facilities were in the hands of a separate terminal company, many economies could be realized in the handling of freight destined for points beyond the terminal or to the terminal itself. The operation of a belt line by a separate terminal company receiving freight from all carriers on equal terms would expedite the movement of freight from rail to ocean carriers and vice versa, and would also lessen the time and effort required for the distribution of freight destined for the port terminal itself. We permitted railroads at one stage of our development to take, through eminent domain, land from private parties to be used for common carrier purposes. With the enormous growth of certain of our port terminals and the increase in the number of carriers which now are in need of terminal facilities, it ought to be clear that the same rule of eminent domain which was applied to secure the land for an individual railroad should now be applied to secure the land and all other terminal facilities for the port terminal transportation companies. In other words, individual railway ownership and control of port terminal facilities should no longer be permitted in our important port terminals. If such ownership were eliminated it would be much easier to give more efficient transportation service at much less expense. This would mean the division of freight rates in carrier accounts into a

line haul charge and a terminal charge. This would not need to annoy shippers, as they would not know that such a division existed; but it could be recorded in the railway accounts, and the terminal services could be made to yield sufficient revenue to cover the cost of terminal services. This would prevent a carrier from using its advantages in terminal location to secure for itself more line haul traffic. In other words, as at present managed, the absorption of many terminal charges by railroads is the means by which traffic may be inveigled to travel over a certain line.

But the elimination of individual railroad ownership and control of port terminal facilities will not solve all our terminal problems. It will be necessary also to compel certain industries to relinquish important port terminal holdings that ought to be used for transportation purposes. The right of eminent domain should be exercised in dislodging interests that now occupy important deep water frontage. In our ports private interests often have exclusive contracts with ocean or rail carriers and these interests are often responsible for the securing of certain exclusive contracts between rail and ocean carriers; all of which may mean more business for the private interests involved and more traffic for certain rail and ocean carriers. From the standpoint of the public, however, it means inefficiency in the use of facilities which in turn slows up the movement of traffic in our port terminals often causing embargoes throughout the entire country. The Transportation act of 1920 might possibly be construed so as to enable the Interstate Commerce Commission to accomplish much in unification of port terminal facilities. But the fact that the conference committee excluded the provisions for compulsory consolidation makes it doubtful whether the Interstate Commerce Commission would feel justified in adopting a vigorous program of compulsory consolidation; and nothing short of such a program will ever give to the public what it has a right to expect in efficient terminal service.

Finally, it is evident that if a program of compulsory consolidation is to be carried out, it will be necessary to recognize the jurisdiction of the national government over terminals and ports that are of national importance. New York City, Baltimore, Philadelphia, Boston, or other ports, should not be permitted to handle their port terminal facilities in such manner as to interfere with the efficiency of transportation from the standpoint of the shippers in Kansas, Colorado, or Iowa. At the present time there are three

important railroads controlling the port of Boston, dividing it, in reality, into three separate ports. In Norfolk, Virginia, for example, although a belt line company handles domestic freight, one of the eight railroads there, the Norfolk and Western, controls the important deep water terminals and hence very largely controls the movement of exports and imports at that port. This road uses its deep water terminals as a means of practically compelling traffic to come in over its own lines if it is to be exported from the Norfolk and Western deep water piers. It likewise places restrictions upon the acceptance of cargo from an ocean liner on its deep water piers unless that cargo is destined for some point on its own system.

Such lack of coördination in port and terminal facilities very often means liberal profits to the carrier or carriers advantageously located within the port, for they are not seriously concerned with the fact that freight congestion exists on their lines. In fact, congestion means to them as individual companies very liberal profits. From the standpoint of the public, however, it is clear that it is not desirable to have congestion of freight within a portion of a port terminal and certain other facilities within the port used much under their capacity.

In conclusion it seems evident that we cannot much longer permit railway companies, private industries, ocean carriers, cities or even states to maintain a policy within our important port terminals which may be profitable to certain interests but against the best interests of commerce generally. If this reasoning is sound we shall continue to have difficulties in this country until federal legislation is enacted which will direct the Interstate Commerce Commission or other authority to compel consolidation of all important port terminal facilities under one ownership and management. The public must insist upon the complete unification and coördination of these important facilities if it is to have sufficient and efficient transportation service.

2. Absorption of Switching Charges [1]

Mr. Justice Day delivered the opinion of the court.

In this case a petition was filed in the District Court of the United States for the Eastern District of Virginia to enjoin an order of the Interstate Commerce Commission concerning the

[1] *Seaboard Air Line Railway Company* v. *United States*, 254 U. S. 57 (November 8, 1920). See Vanderblue and Burgess, p. 210n.

absorption of switching charges on the lines of the Seaboard Air Line Railway Company, the Seaboard Air Line Railway, Southern Railway Company, and Atlantic Coast Line Railway Company within the switching limits of these roads as established at Richmond, Virginia.

The Commission's order was made upon a petition of the Richmond Chamber of Commerce averring that the practice of the railroads was discriminatory and unlawful and violative of § 2 of the Act to Regulate Commerce. From the facts found by the Commission it appears that the appellant railroad companies bring freight from the south to Richmond, Virginia, where the same is delivered to industries in the switching limits of that city. If the freight is received at a point served by any two or more of the carriers, the switching charge is absorbed if the freight be delivered on the line of either. But if the delivery is to an in-

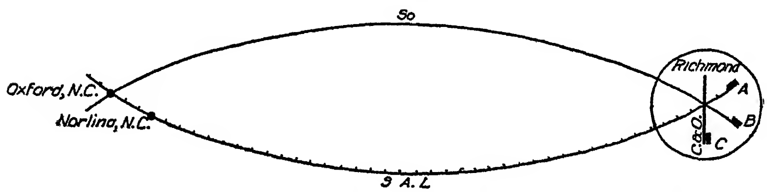


Plate 18.—Absorption of Switching Charges at Richmond, Virginia

dustry served only by a non-competitive carrier the switching charge is not absorbed. The Commission illustrated the point by an example: "Oxford, N. C., is a point reached both by the Southern and the Seaboard, but not by the Chesapeake & Ohio. Norlina, N. C., is a local point on the Seaboard. Assume that industries A, B, and C on the Seaboard, the Southern, and the Chesapeake & Ohio, respectively, are similarly located with regard to the interchange tracks of the three carriers at Richmond. On traffic from Oxford to industry B on the Southern, the Seaboard will absorb the Southern's switching charges. But on traffic from Oxford to industry C, on the Chesapeake & Ohio, the Seaboard refuses to absorb the Chesapeake & Ohio's switching charges. On traffic from and to Norlina, a local point, however, the Seaboard refuses to absorb all switching charges whatsoever to any off-line industry."

The order complained of directed the three carriers to cease and desist on or before August 1, 1917, and thereafter to abstain from absorbing switching charges on certain interstate carload

freight at Richmond, Virginia, while refusing to absorb such charges on like carload shipments for a like and contemporaneous service under substantially similar circumstances and conditions, such practices having been found in a supplemental report to be unjustly discriminatory and unlawful within § 2 of the Act to Regulate Commerce; and "to establish, on or before August 1, 1917, . . . and thereafter to maintain and apply uniform regulations and practices for the absorption of charges for the switching of interstate carload freight at Richmond, Va., and to collect no higher rates or charges from shippers and receivers of such carload freight at Richmond, Va., than they contemporaneously collect from any other shipper or receiver of such carload freight at Richmond, Va., for a like and contemporaneous service under substantially similar circumstances and conditions." 44 I. C. C., 455.

The District Court denied the application for an injunction, and ordered that the petition be dismissed. 249 Fed. Rep. 368.

The contention of the appellants is that the carriage is not a like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions.

Section 2 of the Act to Regulate Commerce provides:

"That if any common carrier subject to the provisions of this act shall, directly or indirectly, by any special rate, rebate, drawback, or other device, charge, demand, collect, or receive from any person or persons a greater or less compensation for any service rendered, or to be rendered, in the transportation of passengers or property, subject to the provisions of this act, than it charges, demands, collects, or receives from any other person or persons for doing for him or them a like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions, such common carrier shall be deemed guilty of unjust discrimination, which is hereby prohibited and declared to be unlawful." (24 Stat. 379.)

Upon this controversy the Commission in its report said:

"Complainant insists that when the line-haul carrier reaches the common point and competes for the traffic to or from Richmond proper, the absorption of the switching charges should not be confined to that traffic for which the switching line competes for the entire haul. That is, if the Seaboard absorbs the switching charges for the shipper on the terminal tracks of the Southern, it should also absorb the switching charges for the shipper on the terminal tracks of the Chesapeake & Ohio. Unless this is done, complainant contends that the two shippers are not upon an

equality, since the Seaboard pays for a delivery service to shippers on the terminal tracks of the Southern and declines to pay for a similar delivery service to shippers on the terminal tracks of the Chesapeake & Ohio. . . .

"Section 2 is primarily directed against discrimination between shippers located in the same community. It is aimed to put all shippers within a switching district upon a substantial equality. It provides that where a carrier receives from any person a greater compensation for any service rendered in the transportation of passengers or property than it receives from any other person for doing for him a 'like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions, such common carrier shall be deemed guilty of unjust discrimination,' a discrimination which is prohibited and declared to be unlawful. Under this section it is settled that the competition of rival carriers as such does not constitute substantially dissimilar circumstances to justify a difference in treatment."

We are of opinion that the Commission was correct in regarding the service in question as a like and contemporary service rendered under substantially similar circumstances and conditions, and amply sustained as matter of law in *Wight* v. *United States*, 167 U. S. 512, and *Interstate Commerce Commission* v. *Alabama Midland Ry. Co.*, 168 U. S. 144. The principle established in these cases is that the statute aims to establish equality of rights among shippers for carriage under substantially similar circumstances and conditions, and that the exigencies of competition do not justify discrimination against shippers for substantially like services.

Moreover the determination of questions of fact is by law imposed upon the Commission, a body created by statute for the consideration of this and like matters. The findings of fact by the Commission upon such questions can be disturbed by judicial decree only in cases where their action is arbitrary or transcends the legitimate bounds of their authority. . . .

The Commission did not hold that switching charges must be always the same. But it did hold that they must be alike where the service was rendered under substantially similar circumstances and conditions. The Commission's report says:

"We do not consider that the carriers must absorb the switching charges indiscriminately to all industries within the switching limits of Richmond if they choose to absorb the switching charges to any one industry off their rails. The illegality herein found to exist is the receiving of a greater compensation for one

service than for a like service under substantially similar circumstances and conditions. To take a concrete example and referring again to the diagram. Suppose industry C were 5 miles distant from the interchange tracks of the Seaboard, while industry B were only 2 miles distant. Suppose the Chesapeake & Ohio's switching charge amounted to \$5, while that of the Southern was \$2. If the Seaboard absorbed the Southern's \$2 switching charge on traffic to industry B, we do not consider that it must absorb the entire \$5 switching charge of the Chesapeake & Ohio on traffic to industry C, but only to the extent to which the service is similar. In other words, it would probably be necessary for the Seaboard to absorb \$2 of the \$5 charge of the Chesapeake & Ohio."

The practice condemned by the Commission, as its report and order show, was that of absorbing switching charges only when the line-haul carrier competes with the switching line; and refusing to absorb such charges when the switching line does not compete with the line-haul carrier; this the Commission held was discrimination within the meaning of § 2 of the Act to Regulate Commerce. We find no occasion to disturb this ruling as arbitrary in character or beyond the authority of the Commission.

We find no merit in the contention that the order of the Commission was too vague and uncertain to be enforced.

Affirmed.

3. Adequacy of Facilities [1]

Harlan, *Commissioner:*

What follows is the report as proposed by the attorney-examiner who heard the evidence in this proceeding, with such changes, however, as seemed to be required, in the light of the exceptions to the report and the argument thereon, to give full expression to the conclusions reached by the Commission upon the facts disclosed of record.

It is maintained by some experts on harbor development that no port is to be regarded as ideal unless its facilities are so arranged as to provide for the direct and economical interchange of freight between the rail carriers and the boat lines serving it. There should be spacious piers on the water front adjacent to the terminals of the rail lines; the railroad tracks should extend onto the piers; and freight should be transferred directly between the cars and the vessels.

[1] *The New York Harbor Case*, 47 I. C. C. 643 (December 17, 1917). See Jones, pp. 392, 455, 559.

If this principle is sound, the very statement of it constitutes a serious indictment of the prevailing conditions at the port of New York, since the terminals of nearly all the trunk lines at that port are on the New Jersey shore, while most of the ocean lines have their piers either on Manhattan Island or at South Brooklyn, distant from 1 mile to 4 miles from the rail terminals. To a specialist in port development it is "a surprising fact that not a single steamship pier on Manhattan Island has a railroad track on it connected to a trunk line railroad, or even to a switching railroad by which the trunk lines might be reached." With a few exceptions there are no facilities on the New Jersey shore for the accommodation of large vessels, which are accordingly obliged to find pier space elsewhere in the harbor. In the absence of bridges or freight tunnels connecting the New Jersey shore with Manhattan and Brooklyn, the problem of providing facilities for the transfer of freight between the cars and vessels is solved by the use of lighters and car floats, which are also employed in transferring freight between the railroad terminals and the piers in other parts of the harbor. The conditions under which freight is transported from one side of the harbor to the other at New York are without an exact parallel anywhere in this country. In *Lighterage and Storage Regulations at New York,* 35 I. C. C., 47, we observed that "the water areas intersecting and adjoining New York City and the crowded condition of Manhattan Island have resulted in the adoption by the carriers of forms of terminal service peculiar to that city," and that "many of the circumstances and conditions which affect the transportation service at New York have no counterpart in the United States."

In spite of the heavy expense incurred by the carriers in lightering and floating freight from one side of the harbor to the other, and in spite of the fact that no corresponding service, except as hereinafter indicated, is performed on traffic consigned to or from points in New Jersey, the rates for the transportation of freight between points in the west and Jersey City, Hoboken, Weehawken, Newark, Paterson, and certain other points in the same state, have been for many years the same as the rates between western points and New York and Brooklyn. The complainants contend that the rates to and from the New Jersey points should be lower than those to and from New York and Brooklyn, and that the defendants' failure to recognize the additional cost of the lighterage and floatage in constructing their rates to and from New York subjects the cities of northern New Jersey to undue prejudice and disadvantage and

their people to the payment of unreasonable rates, and that an undue advantage is thereby conferred upon New York and Brooklyn and the people and industries there located. Since the hearing there has been a difference of opinion as to the exact nature and scope of the complainants' demands. In their petition they ask, in effect, that the rates to and from points in northern New Jersey be made lower than the rates to and from New York and Brooklyn by the amount of the lighterage cost. Since the rates from western points to Philadelphia are only 2 cents under the rates to New York, and since the cost of lighterage is considerably in excess of 2 cents per 100 pounds, it is clear that to construct the rates on the basis suggested in the petition would bring them below the Philadelphia basis. At the opening of the hearing the examiner stated the issues, after which counsel for the complainants read into the record a prepared statement outlining the complainants' position, in the course of which he said:

> It is our judgment that if New Jersey is put substantially upon the Philadelphia basis in the matter of rates it will result in a development of the New Jersey territory in a way that will be of great advantage to the port of New York as a whole. . . .

The complainants take the position that the inadequacy of the present facilities at the port of New York and the consequent congestion of freight there are attributable at least in part to the application of a common rate of freight to and from points bordering on the harbor. As long as the railroads perform the expensive lighterage and floatage service without imposing an additional charge therefor, the freight rates offer no inducement to the steamship companies to seek pier space on the New Jersey shore rather than in Manhattan or Brooklyn; and the maintenance of a common rate to and from both sides of the port tends to increase rather than to diminish the congestion of freight on the shores of Manhattan and Brooklyn. If the freight rates to and from the New Jersey shore were lower, ocean shipping would be attracted to the New Jersey side of the harbor and more industries would be induced to locate there. The complainants contend that this result would be desirable, not only because it would relieve the congestion at the port, an ever-present problem, but because it would enable the defendants to avoid the great expense they now incur in performing a transfer service which the complainants deem unnecessary. There is some disagreement among the witnesses as to whether or not the present practice of handling freight in lighters is wasteful,

nor are they in accord as to the relative advantages and disadvantages of loading and unloading freight directly between piers and vessels on the one hand and lightering it on the other. It seems to be agreed that solid trainloads of some commodities may be loaded and unloaded most economically and expeditiously if facilities are provided for the direct interchange of freight between car and vessel, and that lighters may be employed to better advantage when the cargo is of a miscellaneous character. The vessels entering and leaving New York harbor usually carry miscellaneous freight. In loading a miscellaneous cargo directly from cars to vessel it is important to have the cars shunted onto the pier in the exact order required for the proper loading of the vessel, and if they do not arrive in the proper order confusion and delay result. Lighters, on the other hand, may arrive in any order, and those not needed immediately can be conveniently placed to one side while others are unloading. Moreover, a lighter may contain from 600 to 1,000 tons of freight, from 20 to 30 times as much as the average car. Perhaps the most efficient method is the one employed at the piers of some of the private terminal companies, where a vessel can take its cargo from cars and lighters at the same time; and if the necessary accommodations for ocean-going vessels were provided on the New Jersey shore near the railroad terminals, this method of interchange could be employed to better advantage there than in any other part of the harbor.

The complainants call attention to the fact that approximately 50 per cent of the country's total export and import traffic passes through the port of New York. It is estimated that 10,000,000 tons of freight annually would be affected by a change in the rates here in issue, and that of the total tonnage coming to the New Jersey shore from the west, from 85 to 90 per cent is carried in lighters or on car floats to the east side of the harbor. If it be true that an expensive and unnecessary lighterage service is performed on such an enormous tonnage, it is obvious that the present method of handling freight at the port involves a huge economic loss which is in a sense an unjustifiable burden upon the people of the whole country. The complainants also insist that the defendants' policy of transferring freight across the harbor without imposing a higher rate for that service encourages the continuation of the wasteful practices which have long prevailed, and they contend that the establishment of lower rates to and from the New Jersey side of the port would not only accord to the people of New Jersey an

advantage to which their favorable location entitles them but would relieve the people of the whole country of an unnecessary burden which is directly attributable to the present rate adjustment. . . .

DESCRIPTION OF THE PORT OF NEW YORK

The center of industrial, commercial, and maritime activities at the port of New York is the lower portion of the island of Manhattan. Bounded on the west by the Hudson River and on the east by the East River, both of which will accommodate the largest vessels, and with its southern end protruding almost into the waters of New York Bay, Manhattan Island has all the advantages which excellent facilities for transportation by water can afford. . . .

IMPROVEMENTS BY THE CITY OF NEW YORK

The fact that New York City has lodged in a single department, known as the dock department, authority and control over its water front, has had a most beneficial influence on the progress and development of the port. As early as 1870 the city adopted a carefully planned program for the municipal ownership of its shore front and piers, and during the past 40 years a very large part of the water front has been acquired by the city, which now owns more than 20 per cent of its entire harbor frontage. Of the 104 miles of developed water front it owns 47 miles, or 45 per cent.

Nearly all the extremely valuable frontage on the west side of Manhattan Island is owned by the city. An exhibit filed by the city's dock commissioner indicates that 32 of the 54 railroad piers on the North River are municipally owned, and that of the 47 steamship piers on the west side of Manhattan only 3 are privately owned. A considerable portion of the East River water front also belongs to the city.[1]

[1] The progress made by the city recently in the development of its water front is attributable in no small measure to the fact that in 1898 "Greater New York" came into being. Prior to that time the city of New York embraced only Manhattan and the Bronx. In that year 40 cities, towns, and villages were consolidated into a single municipality. One important result of the merger was a very great increase in the borrowing capacity of the city, which has been able to make much greater expenditures for municipal improvements than it could otherwise have made. A remarkable increase in the population and general prosperity of the city seems also to have resulted from the consolidation. One index to the city's growth is the number of passengers carried annually on the electric lines within the city. In 1898 the number was slightly more than 600,000,000; in 1916 it was 1,890,000,000, an increase of more than one billion passengers. The significance of these figures is indicated by the fact that there were carried on all the steam railroads of the United States in 1916 only slightly more than one billion passengers.

The following table shows to what purposes the water front on the west side of Manhattan is devoted and what percentage is devoted to each, the figures given applying to that portion of the shore front which lies between pier No. 1, North River, at the extreme southern end of the island, and West Thirtieth street, a distance of 3.91 miles:

Nature of occupancy.	Percentage of total	Nature of occupancy.	Percentage of total
Trans-Atlantic steamships	17.5	Open wharfage	3.9
Coastwise steamships	24.3	Coal, ice, oysters, etc	6.9
Railroads	30.8	Recreation piers	.1
Hudson River steamers	3.		
Long Island Sound steamers	5.7	Total	100
Ferries	7.8		

It has been the policy of the city to lease its shore front to railroad companies, steamship lines, and private concerns.

The seriousness of the general terminal problem at the port of New York is due in no small measure to the fact that the most desirable water frontage is inadequate to accommodate all who apply for pier space. Both the railroad companies and the steamship lines regard the west side of Manhattan Island as the most suitable for their purposes, and, in spite of commendable results obtained by the dock department, it has been found necessary to induce some of the applicants to accept pier space in other parts of the harbor. Even prior to the enormous increase in the volume of export traffic which the trunk lines have recently been called upon to carry to the seaboard the congestion of freight at the terminals, on the piers, and in the streets of the city presented a problem which taxed the ingenuity of the carriers and the city authorities.[1] . . .

[1] The present dock commissioner describes the situation as follows: "The necessity for dispatching the business within very limited periods of high congestion morning and evening, combined with the cramped conditions under which freight is handled over the piers and through the bulkhead sheds, has produced a condition which places a most serious burden upon the shippers of the city. West street and the marginal way are at times crowded with trucks to a point where it is impossible to reach the freight stations without intolerable and expensive delays. Testimony which appears entirely reliable has been taken by a number of commissions which have investigated the subject to the effect that several hours' delay in waiting for a chance to receive or deliver freight is no uncommon occurrence, and that the actual cost to the New York shipper of getting freight to and from the waterside stations is frequently equal to or in excess of rail service as far west as Buffalo."

CONCLUSION

The complainants' contention that the methods of handling both domestic and export traffic at the port of New York must be thoroughly revised if the maximum of efficiency is to be attained is abundantly established by the evidence of record. Adequate freight tunnels under the North River, which apparently could be constructed at a cost small in comparison with the resulting benefits, would make it possible to handle a large portion of Manhattan's freight traffic without the use of lighters or car floats. A large part of the valuable water front on the New Jersey shore, now used almost wholly for the transfer of freight between the rails and the floating equipment, could be released for other and more suitable purposes; the congestion on the west side of Manhattan Island caused by the assembling of countless vehicles at the crowded piers to receive and discharge freight would be considerably relieved; and the pier stations on the Manhattan shore, now taxed to capacity, could be devoted in part to other uses.

We can not with propriety overlook the fact that the terminal problem at the port of New York is due in no small measure to competition between the railroads. With convenient through routes available to the shipping public over the lines of all the carriers, and with the same rates of freight applying over all the routes, practically the only field of competition left to the railroads is that provided by their separate terminal operations. A shipper will employ the services of the carrier which offers him the most convenient facilities for the receipt and delivery of his shipments. It is this rivalry between the railroads in the matter of terminal service that has induced them to lay hold of almost every available foot of land on the New Jersey side of the harbor. It is this rivalry that prevents the establishment of reciprocal switching arrangements and joint terminal operation on the New Jersey shore, and for the difficulties encountered in endeavoring to persuade the railroads to construct freight tunnels under the river between New Jersey and Manhattan. And it is this rivalry that tempts the carriers to invest large sums in new terminals for their individual use instead of uniting in a common effort to solve in a larger way a problem whose solution can never be attained as long as the present policy of unrestrained competition is continued. It is not too much to expect that the defendants will take immediate steps to reorganize and coordinate their terminal

facilities at the port. There can be no justification, especially in a time of national emergency, for a policy that permits certain terminals to be congested with a surplus of freight while at the same time a near-by terminal has not enough traffic to keep it busy. It is necessary that the great terminals at the port of New York be made practically one, and that the separate interests of the individual carriers, so long an insuperable obstacle to any constructive plan of terminal development, be subordinated to the public interest. . . .

CHAPTER XVI

ECONOMY OF OPERATIONS[1]

1. Uneconomical Practices

A. INDUSTRIAL RAILWAYS[2]

Harlan, *Commissioner:*

This is a proceeding to determine the legality of the allowances paid by public carriers, east of the Mississippi River, to industries on their rails that own and operate plant railways in connection with their industrial establishments. The allowances are made to the industries or to their subsidiary railways in the form of (a) divisions out of the rate, (b) per diem reclaims, (c) remission of demurrage, and (d) furnace allowances. These various benefits and privileges will be explained later in this report. Involved with that question is the related and equally important question of the legality of the services performed by the line carriers, without charge in addition to the rate, in spotting cars in and about industrial plants that have no locomotives of their own or that have their own locomotives but nevertheless look to the line carriers to switch their traffic to and from any point in the plant in accordance with the demands of the industry. The character and extent of this service will be described later in this report.

The allowances so paid and the free services so performed involve in the aggregate an immense expenditure for which the carriers must necessarily be reimbursed through the rates exacted on the traffic of the general public; at the same time, it must be noted, the allowances and free services so paid and performed by the carriers relieve the particular industries of a large burden of expense which the industries themselves would otherwise have to meet as a part of their manufacturing cost. This operates as a discrimination against the smaller competitors of the favored concerns because, in the nature of things, the benefit of such al-

[1] See Jones, pp. 123–124, 127, 240–241, 400–410, and Vanderblue and Burgess, pp. 78–83, 282–292.

[2] *Industrial Railways Case*, 29 I. C. C. 212 (January 20, 1914). *Second Industrial Railways Case* is in 34 I. C. C. 596. See also cases cited in Vanderblue and Burgess, pp. 80–81.—Ed.

lowances and free services can be enjoyed only by the larger industrial establishments with plant railways.

The importance of the case can not easily be overstated. It is important to the commercial and industrial enterprises now enjoying these special advantages at the hands of the carriers, because of the large and direct financial aid and benefit to the industries resulting from the allowances and free services. It is of no less concern to other large manufacturing and industrial companies which, while similarly situated, are not at the moment so favored by the carriers, but are putting themselves in form to claim these concessions from them in the near future. It is equally important to the great mass of shippers, who neither receive the allowances or free services nor are in a position to claim them, but who, in the open markets, must nevertheless meet the competition of industries so favored and are put by these practices at a commercial disadvantage that is obvious and sometimes very acute. Finally, the matter is of far-reaching consequence to the public, for upon the general public rests the burden of contributing sufficient revenues to the carriers to enable them to meet their expenditures, including those incurred on behalf of the industries so favored, and in addition to earn an adequate return upon the property so devoted to the service of the public.

DEPLETION OF RAILROAD REVENUES

The exact amount of the loss to the carriers resulting from such allowances and free services does not appear upon the record, but the evidence establishes the fact that the depletion of their revenues through these practices is very great. The amount paid in allowances and reclaims is large; and the services rendered free by the line carriers to a relatively few favored industries would, if charged for on a reasonable basis, increase the revenues of the carriers by many millions annually. The practical immunity from demurrage charges, enjoyed by these industries in consequence of these practices, is also a very substantial item.

Allowances.—During the year ending June 30, 1912, the Pennsylvania Railroad paid $1,019,910.41 in divisions out of the rate to only 10 such industrial railways connected with steel plants; the New York Central's western lines paid to 12 such industrial railways an aggregate of $660,057.93; the Baltimore & Ohio paid to 13 such industrial railways the sum of $530,317.06. Five of these industrial railways received from the several lines the addi-

tional amount of $1,059,274 in per diem reclaims. Just how much demurrage these arrangements enabled these industries to avoid is not shown, but the loss in car-service revenues to the carriers must have been very material.

In many of the cases before us on this record the cash revenues received by these plant railways out of the rates of the line carriers are sufficient to lift from the industries the entire cost of their operation. In the instances where the income is said not to be sufficient to do this no account has been taken of the profit to the industry of the elimination of demurrage as a transportation charge against it. When carefully analyzed it is thought that in the majority of cases the industry is under no burden of cost for operating its plant railroad even for its purely interworks switching. And in many instances the plant railway enjoys revenues that are sufficient not only to relieve the industry of the cost of its operation but to enable the plant railway company, besides laying up a substantial surplus, to declare large dividends on its stock held by the industry. In the case of the Baltimore & Sparrows Point Railroad Company, the plant railroad of the Maryland Steel Company, the annual dividends on its stock during the last eleven years have aggregated more than 423 per cent and have ranged from 20 to 55 per cent a year.

Free services.—During the year ending June 30, 1911, the railroads performed for a single steel industry, the Republic Iron & Steel Company, at Youngstown, Ohio, free spotting services on 75,134 cars at a cost to the railroads of $104,329.62, or $1.40 per car. That industry, as a facility in its industrial operations, maintains a system of standard-gauge tracks aggregating between 35 and 40 miles, all located in and around its plant. With these the rails of several railroads connect; and instead of the railroads' transportation service ending where the plant tracks begin, the railroads without additional compensation deliver and spot the inbound loaded cars at such points within the plant inclosure as the steel company requests; and in the same manner they also spot the empty cars for loading. In such cases the superintendent or yardmaster of the industry usually has control of the switching and spotting operations on the plant tracks, although the locomotives and crews are furnished by the railroads and are paid for by them.

The service thus performed by the carrier at large industries where the tracks are owned by the industry and the motive power

and crews are supplied by the carrier is described by a competent witness as follows:

> For inbound material to be delivered at the plant the carrier with its own power first identifies, assorts, and assembles the cars in its own time; it then takes the various kinds of material, the coal, ore, limestone, etc., and groups them, because it is known by the carrier just the different deliveries required for these materials. The cars are then switched to the point of placement and spotted into the unloading position, even to the extent of pushing them up on the high trestles and spotting them over the doors of the bins. The subsequent gathering up of the empty cars, assorting them out, and getting them back into the carrier's yard is done by the carrier with its own power and at its own convenience. The employees of the industry do the loading or unloading, but the entire movement over the industrial tracks is performed with the power of the carrier.

These allowances paid to and free services performed for large industrial establishments obviously relieve them, as heretofore stated, of a heavy burden of expense which the industries themselves would otherwise have to meet as a part of their manufacturing cost; and that manufacturing expense is now borne by the carriers. The amount of the expense was accurately ascertained of record at only a few plants; but the industrial concerns for which such free service is rendered are numerous. On the Pennsylvania lines, east, there are 233 such plants with more or less extensive systems of private tracks within their plant yards on which the line carrier, without charge, now performs the service of spotting empty and loaded cars in and around the plant.

Some idea of the aggregate depletion of the revenues of the carriers, as the result of the allowances, reclaims, free services, and loss of demurrage growing out of these practices in the territory covered by the inquiry, may be had from the above figures, showing the extent of the financial benefits enjoyed in that way by a small proportion of the industrial plants in that territory. The total effect upon the carriers' revenues is obviously a matter of many million dollars a year.

THE JUSTIFICATION

The record amply demonstrates that these allowances and free services were never taken into consideration in fixing the rate but in effect are concessions from the rate. They have grown up as the direct result of competition among the carriers for the traffic, or,

to express the thought more accurately, they are an example of the special concessions and rebates in service that shippers with a large traffic are able to wring from the carriers in consideration of being permitted to handle the traffic or share with other lines in its carriage.

Nevertheless, the allowances actually paid to these industries, or their subsidiary railways, are here sought to be justified by those receiving them on the theory that the industries in handling their own traffic into and out of the plant with their own power, and, as their own convenience may require, are performing a part of the carrier's proper service of transportation for which the industries may be compensated by the line carrier out of the rate. The free services are sought to be justified on the theory that the transportation service of the line carrier properly extends into a plant and to and from each separate building and point within it that is reached by the plant rails.

FUNDAMENTAL PROBLEMS INVOLVED

The problems arising out of these practices are so presented on the record as to require us to dispose of them upon fundamental grounds. In other words, the privileges and advantages of this character, now enjoyed by a relatively small number of more or less extensive industrial establishments, must either be held to be an unlawful concession to them by the carriers or, if lawful, the principles upon which they may be justified must be ascertained and clearly defined so that like privileges and advantages may be claimed, as of right, by all industrial establishments served by these carriers, whether they be large or small. The allowances and free services to which we refer very materially increase the operating expenses of the carriers, are a heavy drain upon their earnings, and as heretofore stated must be provided for out of their general revenues. It follows, therefore, upon a large view of the record, that the real question before us is whether the particular industries, which these plant railways serve and by which or in the interest of which they are owned, are themselves to bear the burden of operating them, or whether the allowances and free services which the line carriers now pay to and perform for these industries, a class of shippers that necessarily must always be relatively small in number, are to remain a burden the cost of which may be spread by the carriers through their rates over the traffic of the entire public. If the allowances and free services

may on any ground be justified and found to be lawful, they will on like grounds be claimed by and must in the near future be extended to all industries similarly situated. We are therefore at the parting of the ways with respect to this very heavy tax upon transportation. Many other industries not now enjoying such allowances are only awaiting our approval of them here before claiming like favors from the carriers as of right; and it is certain that if these practices are now found to be lawful the announcement of our conclusions will at once be followed by preparations on the part of similar industries throughout the country to throw upon the carriers the cost of operating their plant railways. Such a ruling now not improbably would fix this relation between the line carriers and the more or less extensive industries of the country as a permanent practice, the burden of which must be borne through increased rates by the general shipping public.

RELATION OF THESE PRACTICES TO RATE INCREASES

Indeed, the very carriers that are augmenting their expense accounts and dissipating their revenues in this manner, to the extent of many millions of dollars a year and for the benefit of a comparatively few shippers, are now complaining that their present earnings are insufficient and, on that ground, have asked our permission to make a substantial increase in their general rate schedules. In that sense the proposed increase in rates has a certain very definite and immediate relation to this proceeding. In this general connection it may safely be assumed that no substantial part of the well informed and reflecting public would deny to the owners of the railroads of the country a reasonable return on their investments; nevertheless, before they may fairly ask the general public to share further in carrying their burdens, it is manifest that the railroads must themselves properly conserve their sources of revenue by making every service rendered by them contribute reasonably to their earnings. This having been done, the Commission upon an adequate showing of the need of additional revenues will not shrink from the responsibility of sanctioning such measures, including even a general increase in rates, as may be required to bring reasonable prosperity to railroads, so far as this may be accomplished under rates and charges that are reasonably just alike to shippers and to the carriers. Aside from the right of the owners of the property so devoted to the use of the public to receive from the public a reasonable return on their

investments, it is of profound importance to the public in its own interest to accord fair and equal treatment to the owners of railroads, for upon no other basis may we continue to look to private capital for the further development and extension of our railroad facilities. The general public interest is therefore advanced in a very direct way by the reasonable success of railroad investments under rate schedules that reasonably respect the rights of shippers. But if further burdens through an increased scale of rates may justly be imposed on the general public, all must agree that unlawful concessions, rebates, and preferences in the interest of a small proportion of the shipping public ought to be eliminated from the practices of carriers. It is therefore appropriate, as it is also our duty on general grounds, to examine carefully into the legality of the allowances, free services, per diem, and demurrage concessions, of the character disclosed on the record before us, by means of which the revenues of the carriers are so heavily taxed and their net earnings so largely impaired; and we now take up the consideration of that question with a full appreciation of its far-reaching importance. . . .

CHARACTER OF INDUSTRIAL RAILWAYS

It would unduly extend this report to undertake here to describe each of the iron and steel industries and their plant railways as the facts in relation to each are spread of record. For convenience of reference this has been done in an appendix attached to the report. There are, however, certain features that are characteristic of all these plants. The ordinary plant consists usually of blast furnaces, steel mills, rolling mills, and other manufacturing departments. It covers from 25 to 125 or more acres of land, in many cases inclosed by fences and gates. One of the important problems that each plant must meet in its own way is the disposition of slag and other refuse that accumulate in large quantities from the operation of the furnaces and mills. A convenient dumping ground must be provided, and this, partially at least, is the explanation of the location of the plant in practically every instance either on a river bank or lake shore, where the submerged lands may be filled up to the established harbor lines, or on or adjoining lowlands or gullies where the refuse may be conveniently dumped. In practically every instance plant rails and locomotives are provided as a means for disposing of these waste materials, and a surprising amount of low or submerged lands have in that way been

brought up to grade and made available for the extension of the plants themselves or for use by other industries. Some of these made lands are of great value. The plants, however, have various other and still more important uses for rails and locomotives, and it is repeatedly admitted of record, and abundantly illustrated in the case of all these plants, that locomotives and a system of rails in and about an iron and steel plant are a necessary facility in the industry. The plant tracks ordinarily are used not only for the movement of cars between the rails of the line carriers and various points within the plant, but they are required for the prompt and economical movement of material between its various departments. In some cases they are operated as a bureau or department of the industrial company; but at this time in the majority of instances they are operated by an incorporated railroad company owned by the industry. In many cases the industrial railroad performs only the interchange switching with the line carriers, while the industry, with other power, does the interwork switching itself and not through its plant railway company. In other instances the incorporated industrial railroad performs all the switching within the plant as well as the switching to and from the rails of the line carriers. In addition to the standard-gauge spur and switch tracks in and about these plants all the larger iron and steel industries maintain a system of narrow-gauge tracks operated with their own power and confined exclusively to mill work. In all cases there is a practical identity in the ownership of the plant railway and the plant.

In the case of some of the plants the industrial railroad company owns no physical property, but formally leases its right of way, tracks, and equipment from the industry by which it is itself owned; in other cases the industrial railroad company owns the equipment and leases the tracks and right of way from the industry; and in still other cases the right of way has been deeded to the industrial railroad company in fee, and the tracks and equipment have been assigned to it. At the majority of the iron and steel plants described of record the rights of way of the line carriers adjoin the property line of the industry, and in such cases the interchange of cars with the plant could readily be performed by the line carrier by means of a short switch track. In a few cases only is the plant located at a distance from a line carrier; in such cases the industrial railroad usually extends its rails to the trunk line; and the extraordinary financial results accruing to the

industry, in the way of divisions and allowances, as a consequence of such an arrangement, are fully shown of record. At a number of plants the tracks of two trunk lines parallel and adjoin the property of the industry and each of them formerly extended its switch tracks to a junction with the plant tracks either just within or just outside the plant inclosure. When the plant tracks were taken over by the incorporated plant railroad the tracks of the latter were extended around the plant in such manner as to exclude the trunk lines from direct access to the plant except over the rails of the newly incorporated industrial railroad. The result is an apparent intermediate service by the industrial railroad between the plant and the line carrier, on the basis of which the plant railroad exacts compensation, not from the industry, but out of the rate of the line carrier. In several instances the right of way of a trunk line originally ran directly through the plant inclosure, and when the incorporated industrial railroad assumed the operation of the plant tracks the trunk line tracks were removed and relocated at a point outside the plant inclosure. These arrangements were usually accomplished by an exchange of property, the trunk line deeding its old right of way to the industry, or to its plant railway, in return for a deed of its new right of way acquired for the purpose by the industry. While the ostensible object of these transactions was to give the industry more room for the location of its mills and buildings, often the real purpose, and in all cases the actual result, was to give the industry a better opportunity to interpose its plant railway between its plant and the trunk line, so that the industrial railroad could have an apparent basis for allowances. The cost of relocating the trunk line is usually included in the capital account of the industrial railroad. . . .

A PLANT RAILWAY AN INDUSTRIAL NECESSITY

The modern steel plant covers a large area, and every provision must be made to reduce the manufacturing cost and to provide against the loss of efficiency. The most important facility in accomplishing this is the plant railway, by which, in addition to the inbound movement of ore, coke, and limestone, is secured the prompt distribution of material and supplies from points of storage to the various departments. Slag, ashes, and other waste materials must be quickly removed and taken to the dumping grounds provided for that purpose, as heretofore explained. All this is mani-

festly a part of the manufacturing process and is no more related to transportation than it would be if done by horse and wagon. In other words, a plant railway is as necessary a part of the plant equipment as is the plant smokestack, and, as before stated, this is one of the facts completely established on the record.

The record makes it clear also that the successful operation of a blast furnace requires a continuous movement of ore, coke, and limestone to be ready at the precise time and in the proper proportions to meet the requirements of the furnaces. The absolute necessity of this regularity of service at the furnace is repeatedly referred to on the record. Nevertheless it is contended, that when these raw materials are brought in by the line carriers, in the proportions and at the time required by the industry, this is not a feature of the industrial processes of the plant, but is a service of transportation which the line carriers must perform or pay the industry out of the rate for performing with its own facilities. In many cases the tracks on which these deliveries of coke, ore, and limestone into the furnace bins are made are elevated on trestles adjoining the furnaces. At perhaps most of the plants here described hot metal from the furnaces is moved to other departments of the plant on the narrow-gauge tracks, but in some cases this is done entirely by the standard-gauge plant railway. In most instances the movement of partially manufactured products from one mill to another is very extensive, and a large part of this interworks service is ordinarily done by the plant railway.

Some of these iron and steel industries were originally small concerns with a spur track holding only a few cars. Their growth, however, has been rapid, and with it has followed an increase in the number of buildings and departments and in the extent of land occupied. This involved also an increase both in the extent and in the number of spurs and switch tracks in the plant. As heretofore stated, there is usually also a narrow-gauge system of tracks in the mills and connecting the different mills. There are cranes and other appliances scattered about the works. All this makes a situation so complex that the trunk lines that have undertaken to do the switching, both within the plant and to and from it, have found it necessary to have one control, and one of them ordinarily does the work, the expense being pooled and divided among them all. This is the case where the plant itself provides the tracks but does not undertake to operate them. In most of the cases described of record, however, the plants have altogether excluded the trunk

lines from their plant rails and do all the work with their own power. So great is the complexity at many plants as to make it practically impossible for any outside power to undertake the work. This was made clear by several witnesses. An official of one of the largest plants in the country, after explaining the great cost of operating its very extensive plant railway was asked why his company did not permit the trunk lines to do the work there as they do at some other plants. He explained that his company would prefer to bear the expense itself rather than to try such an experiment. Nevertheless, in a number of smaller plants east of the Pittsburgh district the trunk lines do all the work inside the plant as well as to and from it.

DELIVERY OF CARLOAD FREIGHT

Under the common law as construed in the practically unanimous decisions of the courts, a delivery of carload freight to a shipper having a private siding is made by shunting the car upon the switch, clear of the main tracks. All services upon the siding beyond that point, in placing the car for loading or unloading at a particular spot convenient to the shipper, are what may be called volunteered services in the sense that they are in addition to the main-line haul and in excess of any obligation of service by the carrier at common law. Nevertheless the custom of making deliveries at the warehouse or factory door on private sidings is one of long standing in this country, and under certain language in the act it is possible that the carriers may be required, upon reasonable compensation, to do this spotting, as it is called. We find no authority, however, English or American, that holds or intimates that the line carrier, in connection with the main-line haul, is under any obligation to spot a car at the factory door on a private siding except upon reasonable compensation included in the rate itself or set up in the form of a special charge.

These private sidetracks or sidings, as they are more commonly called, are constructed to facilitate the receipt and delivery of carload freight. They either connect a particular warehouse, factory, or elevator with the main line of the carrier, or, in the case of an industry having plant tracks of its own, they connect the main line of the carrier with a point of interchange with the plant tracks. Ordinarily the private siding is a short track to a coal or lumber yard, or to a factory, warehouse, or elevator adjoining the right of way of the line carrier and having a

door or platform where the car may conveniently be loaded or unloaded. In England a car shunted by the carrier upon a siding is spotted by the industry, this being accomplished ordinarily by means of a winch and cable. But in this country, although it is often done with a pinch bar or other appliances, the heavy modern equipment makes it much more convenient to spot a car at a factory door with a locomotive, and the line carriers quite generally perform the service. Although the practice is not absolutely uniform throughout the country, the spotting is customarily done without any charge in addition to the published rate. It is, however, a special and particular service of peculiarly direct value to the shipper in that it not only secures prompt delivery to him, but enables him to avoid the expense of cartage, which in many cases would be very substantial. Such a service when included in the rate gives the shipper a very obvious advantage over a shipper who at the same rate must accept and deliver his traffic on a public team track and cart it to and from his factory or place of business; and the shippers who labor under this disadvantage far outnumber the other class of shippers. Whether under such circumstances a special charge, in addition to the line rate, should be exacted for spotting a car on a private siding of the usual and ordinary kind—that is to say, one leading to an elevator or to a door or unloading platform of a factory or warehouse—is undoubtedly a question that should and necessarily must have most careful consideration. That, however, together with free store-door delivery, ferry car, and other free services by which, at the cost of the carriers, the relatively few shippers of large traffic are relieved from the expense of cartage, is a question that can not appropriately be disposed of finally in this case; and the spotting of cars without charge at the doors of factories or warehouses on private sidetracks has been referred to here in order that we may have the benefit of the contrast of that service with the very much more extensive service performed by the line carriers without additional charge for the larger industries that have, and require in their industrial operations, a more or less extensive system of tracks in and about their plants. We get an even more significant view of the matter when we contrast the ordinary switching service, without charge in addition to the line rate, on a switching track leading to a door or loading platform at a factory or warehouse, with the allowances and divisions surrendered by the line carriers out of the same rates to other large industries having, as an indus-

trial necessity, an intricate system of tracks within their plants which they operate directly with their own power or indirectly through an incorporated railroad company owned by the industry. Throughout the territory under consideration here the same rate that is exacted for a public team-track delivery, with the cartage charge which it entails upon the shipper, will give another shipper the service of spotting the car at his warehouse on a siding, without attendant cartage expense; it will also purchase for an industry the service of spotting the car at any point within its plant, or entitle it to allowances for doing this for itself. The resulting inequality in the value of the service rendered, as between these different classes of shippers, is very striking; and the very great additional cost to the carrier in performing the plant service is equally apparent.

PUBLIC SERVICES OF INDUSTRIAL RAILWAYS

One or two of these plant railways operate passenger cars for the convenience of their own employees going to and from their work, and incidentally carry a small number of passengers not connected with the industry. The remaining industrial roads described of record have no passenger traffic and have no opportunity to serve the public in that way. None of them carries mail or express; only one issues bills of lading, and but one of them has a depot for less-than-carload shipments and that was constructed during the progress of the hearing. Although much is said of record about terminal roads, not one of these industrial short lines is in any sense a terminal railroad as that phrase is ordinarily used. The road that has most nearly the appearance of a terminal road claims only three per cent of outside traffic. Moreover, the record shows that, generally speaking, outside business is not solicited but on the contrary is discouraged. In the great majority of instances there is no real outside traffic. Where any such traffic exists it is almost negligible, except in three or four cases. According to their own figures the outside traffic varies from one-quarter of one per cent to a maximum of 12.66 per cent in the case of the South Buffalo Railroad. The three or four instances where it is really appreciable will be specially considered.

The legality of allowances to plant railways of this character was considered from a somewhat different point of view in *General Electric Company* v. *N. Y. C. & H. R. R. R. Co.*, 14 I. C. C., 237. There the complainant, conducting a great industry with an exten-

sive system of plant rails and locomotives of its own, asked for an order requiring the defendant carriers to make it an allowance out of the rate for operating its plant railway in the movement of its own traffic to and from various parts of its plant. It appeared that in 1886 there were, on the site in question, two factory buildings connected with the main line of the carriers by a switch track over which the carriers were accustomed to deliver carload freight without extra charge, the less-than-carload freight being hauled from their freight stations to the plant by the industry with its own horses and wagons. In 1908, when the case was before us, the business had so expanded that the complainant's plant embraced an inclosed area of 180 acres upon which there were 140 buildings of varying size, including 50 or 60 shops, foundries, and warehouses, in which about 17,000 men were ordinarily employed. Within the inclosure were 12 miles of standard-gauge track, in addition to 7 miles of narrow-gauge track, all of which the industry was operating with its own power. At a point of interchange between the line carriers and the plant railway, namely, on certain storage tracks just within the plant inclosure, the complainant during that fiscal year had delivered to the line carriers about 25,000 loaded and empty cars, and at the same point of interchange it had received about the same number of inbound loaded and empty cars. The service of the line carriers did not extend beyond the storage tracks. From that point the inbound loaded and empty cars were moved by the industry to the various loading and unloading points within the plant; the outbound cars, loaded at various points within the plant, and the outbound empty cars were also delivered at that point to the line carriers by the plant railway. For all this service on its own traffic between the interchange tracks and the various points of loading and unloading within the plant the complainant contended that it was entitled, under section 15 of the act, to be reasonably compensated by the line carriers out of the rate. The contention was based on the theory that the complainant was doing a service of transportation and furnishing facilities of transportation with respect to its own traffic which the line carriers would have to perform and furnish under the published rate if the complainant chose not to perform and furnish the service and facilities for itself. We held, however, that the service beyond the interchange tracks was not a carrier's service, or a part of the transportation undertaken by the carriers, but was a shipper's service—a service apart from transportation

that was performed by the shipper for its own benefit on tracks and with facilities within the plant inclosure that were laid and used for the complainant's own convenience and as necessary facilities in the conduct of its manufacturing operations. We also held that a carrier, when serving industrial plants of that character, performs its full duty under its contract of transportation when it delivers or accepts cars at some reasonably convenient interchange point, such as the storage tracks provided for the purpose by the complainant within the plant inclosure. We further held that the line carriers are under no duty to extend their transportation obligations with the extension of great industrial plants, like that of the complainant, and could not lawfully be called upon, as a part of the service of transportation, to make deliveries through a network of interior switching tracks, constructed as plant facilities to meet the necessities of the industry; and that their obligation as common carriers involves only a delivery and acceptance of carload shipments at a reasonably convenient point of interchange between their main line and the plant tracks of the industry. We, therefore, dismissed the complaint upon a finding that the complainant performed no service for itself within its plant which it could lawfully call upon the line carriers to perform for it, and that there was, therefore, no basis for its demand for compensation from the line carriers out of the rate. . . .

It will be observed . . . that the line carriers were declining to perform any service within the plant beyond the interchange point, and we held that no service beyond that point could lawfully be required of them and, therefore, that they could not be required to make an allowance to the industries for doing the service for themselves with their own facilities. The attitude of the carriers before us here is just the reverse. Under the compulsion of the large traffic of these steel and iron plants the line carriers have been forced by the industries to extend their service beyond the interchange tracks and, without charge in addition to the rate, they are either doing the very service within the plants which, in the cases cited, we said the defendant carriers could not be required to do, or they are paying the industries allowances for doing the service within their plants for themselves with their own facilities. They are volunteering a service in excess of their legal obligation of service and are receiving no compensation for it. And the question here is whether this may law-

fully continue; that is to say, whether the line carriers may continue without additional charge to perform the very extensive switching service beyond the interchange point and to and from all points within the plant inclosures of industries that have no locomotives, and of industries that have locomotives but prefer to have the line carriers do the work; and whether they may lawfully continue to pay allowances out of the rates to other industries which, with their own facilities, perform the switching service beyond the interchange tracks and to and from all points within their plants.

UNDUE DISCRIMINATIONS INEVITABLE

That these practices result in undue preferences and unjust discriminations is fully shown by the record. We regard them also as unlawful in and of themselves. Indeed, the surprising feature in the situation is that they have been permitted to continue so long. That they have grown out of competitive conditions between the line carriers was not only admitted at the hearing but is abundantly demonstrated by the testimony. In the case of 20 incorporated roads described of record, 16 receive allowances and four do not. Of the 10 unincorporated plant railways, three receive allowances and seven do not. Of these seven industries the interchange switching in two instances is performed by the connecting trunk lines under a pooling arrangement, the cost being divided between them on a car basis; at one of them the interchange and the interworks switching is performed by the industry and the cost divided between it and the trunk lines on a car basis. At the other four of these seven industries the entire service is performed by the industry without allowances of any character. These differences in treatment are not the result of different conditions at the plants but grow out of the competition among the carriers for the traffic. In the same district no allowance is paid to one plant railway, a small allowance is made to another, while a large allowance is paid to a third. When asked to explain the payment of allowances to some industries and not to others similarly situated, a witness for one of the line carriers said it had never differentiated between them on principle but only as the result "of competition and the force of circumstances. . . . I do not think we have ever made one of these allowances willingly and voluntarily." The lack of uniformity is also shown in that in some cases the trunk lines make no allowances beyond the so-

called furnace allowances, while in other cases allowances are made by them on both inbound and outbound shipments ranging from $1 to $2.50 per car. In one case they are fixed at $2.50 per car on inbound material and $4 a car on the outbound manufactured products. Upon the whole record it may be taken as fully established that the allowances are not regarded as having any relation to the rate or, as heretofore stated, as having been taken into consideration in fixing the rate; they are simply concessions out of the rate to secure the traffic. This is no less true of the free service of the trunk lines in participating in the manufacturing process by arranging in many cases, as heretofore explained, to switch the cars of raw material into the plant, not in accordance with their own convenience but in such manner as to meet the requirements of the furnaces. And in the history of the industry it has occurred not infrequently that the failure of the line carrier to do this properly has resulted in closing down the mill. It is partly to avoid this risk that the larger industries as a rule prefer to do the switching with their own facilities, and have the trunk lines pay for it with allowances.

PER DIEM RECLAIMS

The depletion and loss in the revenues of the line carriers, through this voluntary and preferential contribution in money and services to a relatively few industries, has already been adverted to, but it is more extensive than has been generally understood. The payments made to large shippers by the trunk line carriers east of Chicago, in the form of allowances to their industrial or plant railroads, aggregate many millions of dollars a year. A large additional amount is also annually contributed by the line carriers to the same industries through the so-called per diem reclaims.

In order to have a clear idea of the practice of carriers in the matter of per diem charges and of the important privileges resulting from it to these iron and steel industries, it is necessary to understand the modified agreement, which is the basis upon which the line carriers settle with switching roads for the detention of their equipment. The ordinary switching or terminal line, when a party to the per diem agreement, is under an expense of 45 cents a day for each car of a trunk line held upon its rails. Usually such lines have no equipment of their own upon which they in turn may earn revenues from the trunk lines. In order, therefore,

that the per diem charge may not unduly deplete the revenues of the switching lines, the latter under the modified agreement are entitled to make a reclaim against their immediate trunk-line connections for a stipulated number of days, the period, as contemplated and intended under the practice, being based upon the actual experience of the respective switching lines in the necessary detention of cars on their rails. The periods agreed upon with the industrial lines before us range from three and one-half days in the case of one plant railway to a maximum of five and one-half days, and appear in some cases to be substantially in excess of their reasonable necessities. During the period so designated for a given industrial line it is required to pay, to the trunk line owning the car, a per diem charge for the number of days the car is actually on its rails; but, under its right to make reclaim for the whole period upon its immediate trunk-line connection, the industrial line makes a profit of 45 cents per day for each day saved out of the designated reclaim period by the prompt return of the car. The industrial lines that have been given the benefit of the modified agreement are not only practically relieved of the payment of per diem charges but, through these arrangements, many of them receive a substantial addition to their revenues, which accrues to the benefit of the controlling industry.

To the iron and steel industry this charge or per diem reclaim in many instances has become the source of large revenues to the plant railways and to the industries that own them. Of the 30 industrial railroads, parties to this proceeding, 10 are parties to the per diem agreement. It is shown of record that for the year ending June 30, 1911, the aggregate amount of per diem reclaims received by only five of these roads amounted to $1,059,273.99. The full results of the arrangement ought to be clearly appreciated. It means that instead of the 48 hours of free time accorded to ordinary shippers, these industries have from three and one-half to five and one-half days of free time, the possession of the car by their plant railway not being charged against the industry. Moreover, when the car is returned to the line carrier in less than these periods the industry earns a bonus or reclaim, which in the case of one of these industries aggregates more than $600,000 a year, out of which the clear profit must necessarily be very substantial; the bonus in nearly all cases is large, and in many cases a profit results. Just how much demurrage these industries escape from paying to the line carriers, on the fiction that a car in the possession of their

industrial or plant railroad, and ordinarily inside their own plant, is not in their own possession, and therefore not subject to demurrage, is a matter of conjecture; but undoubtedly the results flowing from it give to that fiction a very large annual money value to each of these industries. Even when such an industry detains a car beyond the maximum period of time allowed to its plant railway under the per diem agreement, and a demurrage charge results, the industry pays it not to the line carrier, but to its industrial railroad and therefore into its own treasury. As to those industries, demurrage is therefore entirely eliminated as a transportation charge. Competing industries, on the other hand, that have no such advantages must pay demurrage to the line carrier for the detention of all cars beyond the 48 hours of free time allowed in the tariffs, and they have the benefit of no per diem reclaim. Since these facts were developed in the course of this investigation, these matters have been the subject of conferences among the line carriers and with these industries; and we are advised that an understanding has been reached as the result of which per diem reclaims, after January 1, 1914, will no longer be a source of revenue to the industries. They are, however, still to enjoy immunity from demurrage.

SWITCHING AND SPOTTING

In addition to the cash revenues lost by the line carriers through reclaims and the complete elimination of demurrage as a transportation charge against such industries, there is the gratuitous switching service performed by the line carriers in many large plants which have installed extensive spur and switch tracts in and about their mills and other buildings for necessary industrial purposes, and yet look to the line carriers to extend their rates to every door and other point within the plant, regardless of its size or the intricacy of the plant tracks or the cost of the service; and to do their inbound and outbound switching without charge, and even to do their interworks switching, in some cases without profit. It is impossible to estimate the aggregate cost to the line carriers of this free service in the territory east of the Mississippi River, but the amount is very large and its reasonable value to the shippers for whom it is performed must amount to many millions of dollars a year.

In short, we are here dealing with preferences and discriminations on a huge scale and with services rendered by the line carriers

which, if charged for on a reasonable basis, would increase their revenues by millions of dollars annually. The conditions on the Pennsylvania lines east of Pittsburgh will alone be sufficiently illustrative. It has 4,200 private siding connections, of which 3,800 are of the simpler form with a capacity of a few cars each. On these sidings the spotting is done without any charge in addition to the line rate. On its various main and branch lines there are about 400 more or less complicated systems of tracks within plants. At 233 of these industries the line carrier, entirely without charge in addition to the rate, and notwithstanding the fact that it is under no such obligation, performs the service of spotting empty and loaded cars in and around the plant; at 145 the spotting is done with the power of the industry, and at 24 the service is performed partly by the industry and partly by the carrier. Of the 145 plants in which the industry does the work with its own power a majority have not incorporated their plant railways. Where the plant tracks and locomotives are incorporated, the line carrier delivers the inbound cars and takes the outbound cars at designated interchange tracks within the plant or just outside. One railroad witness of much experience testified that the line carriers had accepted the incorporation of a plant railway as notice to them to keep out of the plant. . . .

We find and conclude on the facts of record that . . . all the service by the line carriers beyond a reasonably convenient point of interchange between the rails of the carrier and the rails of the industry, either within or without the plant, is a shipper's service and not a service of transportation which the line carrier may perform without charge or may allow for out of the rate through divisions or otherwise when performed by the industry or by its industrial railroad, and that the facilities used by the industry in performing the service, whether separately incorporated or not, are plant facilities and plant equipment. We also conclude and find that the delivery of a car by a line carrier upon the exchange track is a delivery to the industry, and that the elimination of demurrage, under the present practices, as a transportation charge against the industry is unlawful and gives the industry so favored an undue and unreasonable preference and advantage. We further find and conclude that undue and unlawful preferences and discriminations arise out of the present practice of the line carriers in performing such services without additional charge and in making allowances therefor out of the rate when performed by

the industry or by its plant railway. We further find and conclude upon the record that the line carriers are not compensated for such services in their rates and that the allowances therefor out of the rates are unlawful rebates paid for the traffic, and when performed by the line carriers are unlawful rebates, in service, paid for a like purpose. [1]

B. ALLOWANCES TO AN INDUSTRY [2]

EASTMAN, *Commissioner:*

This proceeding brings in issue the lawfulness of divisions of through interstate rates on carloads of lumber and forest products moving from the proprietary mills of the Prescott & Northwestern Railroad Company and the Ouachita & Northwestern Railroad Company. The question is the same as to each tap line; the cases were heard together and will be so disposed of in this report.

At a hearing held after service of a tentative report upon the two railroad companies above named and the Missouri Pacific Railroad Company, the parties in interest, it developed that certain of the practices which were questioned had been eliminated. One practice of the Ouachita & Northwestern Railroad Company in hauling lumber destined to St. Louis and other northern, eastern, and western points from the mill at Clarks 25 miles to its junction with the Tremont & Gulf Railroad, whence the cars were transported by the latter company by way of Menefee Junction to Rochelle and delivered to the Missouri Pacific, thence by the Missouri Pacific back to Clarks and on to St. Louis, had been discontinued; but the tariff covering this unnecessary route has not yet been canceled.

It is not necessary to discuss other practices mentioned in the tentative report which had been eliminated or were satisfactorily explained. We shall confine ourselves, therefore, to the consideration of two practices, one of the Prescott & Northwestern Railroad Company, and the other of the Ouachita & Northwestern Railroad Company, which existed at the time of the hearing.

1. The Prescott & Northwestern Railroad Company is a tap line organized as a common carrier under the laws of Arkansas,

[1] For modification of these holdings, see Supplemental Report, 32 I. C. C. 129; *Second Industrial Railways Case*, 34 I. C. C. 596; and *Car Spotting Charges*, 34 I. C. C. 609.—Ed.

[2] *Wasteful Service by Tap Lines*, 53 I. C. C. 656 (June 30, 1919). See Jones, pp. 123–124, and Vanderblue and Burgess, pp. 80–83. The Commission, on further hearing, 89 I. C. C. 327, upheld the opinion here reprinted, and entered a formal order so that the question involved could be carried to the courts by the tap lines.—Ed.

and is affiliated with the Ozan-Graysonia Lumber Company. A full description of this road is given in our report in *The Tap Line Case*, 23 I. C. C., 549, 569, and the following sketch shows the rail lines.

The Ozan-Graysonia Lumber Company owns and operates a mill at Prescott, Ark., on the Missouri Pacific Railroad and the Prescott & Northwestern. The mill is located at a station on the latter road called Dian, and is less than 1 mile from the junction point of the two railroads. All interchange traffic with the Missouri Pacific

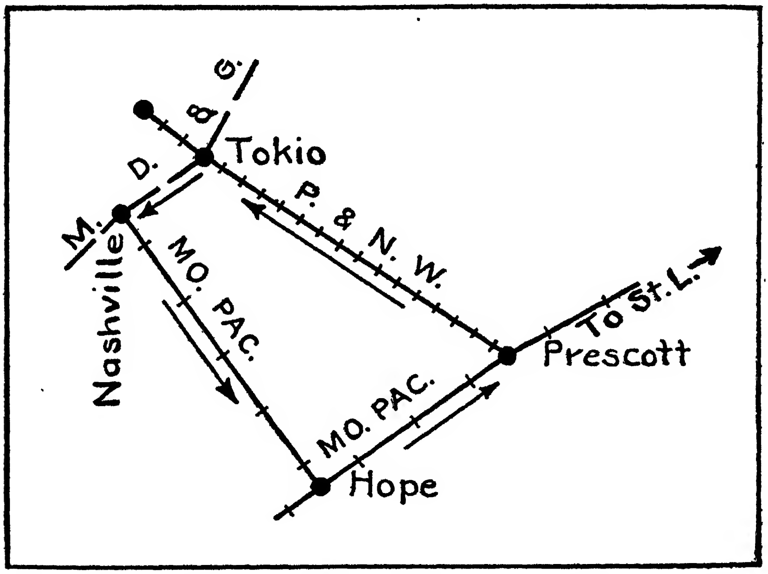


PLATE 19.

may be received or delivered at Prescott, involving a movement by the Prescott & Northwestern of less than 1 mile. Instead of doing this, it has been the practice of the Prescott & Northwestern to haul all cars of lumber and forest products intended for the Missouri Pacific 29 miles to Tokio, Ark., and there deliver them to the Memphis, Dallas & Gulf Railroad. The latter company transports them to Nashville, Ark., where they are delivered to the Missouri Pacific; the Missouri Pacific then conveys them via Hope Junction, Ark., and, if destined to St. Louis, or northern, eastern, or western points, back to Prescott. In other words, instead of delivering the products of the proprietary mill, destined to points on the Missouri Pacific or beyond, by a simple switching

movement, the traffic is carried out of line for 76 miles and brought back to Prescott, and then proceeds to destination. The tap line claims the right to make this circuitous and unnecessary haul in order that it may earn a larger division out of the through rate.

2. The Ouachita & Northwestern Railroad Company is organized under the laws of Louisiana as a common carrier and is affiliated with the Louisiana Central Lumber Company. A description of this road is given in our report in *The Tap Line Case*, 23 I. C. C., 549, 603. The Louisiana Central Lumber Company has a mill at the point called Clarks, La., and another at a point called Standard, La., 10.5 miles south of Clarks. The two mills are connected by a track of the tap line paralleling the main track of the Missouri Pacific, but the direct haul over the tap line to a junction with the Missouri Pacific in each case is less than 1 mile. The sketch . . . shows the location and the connecting lines.

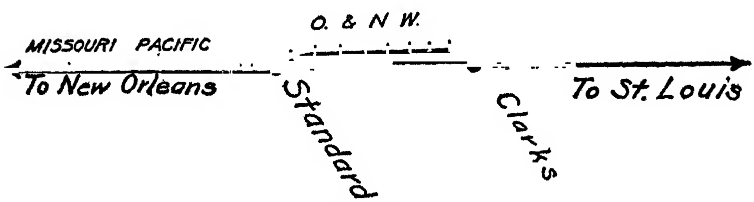


PLATE 20.

A large portion of the traffic from the mill of the Louisiana Central Lumber Company at Clarks moves to St. Louis and eastern and western points over the Missouri Pacific. It has been the practice of the tap line to haul this traffic to Standard, where it is delivered to and hauled by the Missouri Pacific back to Clarks, whence it moves to final destination. A like unnecessary and circuitous haul has been the practice in the case of the products from this company's mill at Standard. Here a large portion of the product of the mill is for export and goes to New Orleans. This traffic has been hauled by the tap line to Clarks and there delivered to the Missouri Pacific, which latter company hauls it back through Standard to its destination. No question is raised as to the right of the tap line to haul lumber which is destined to New Orleans and the south from the mill of the lumber company at Clarks to Standard, making delivery there, as that movement is in a direct line toward the point of final destination; nor is any question raised as to the right of the tap line to haul the products

of the mill at Standard intended for St. Louis and eastern and western points to Clarks, and there make delivery of such traffic to the Missouri Pacific. The practice that is questioned is the unnecessary hauling of lumber by the tap line from either mill in the opposite direction from its destination and out of line, making deliveries at points that involve the return of the traffic to the station at which the originating mill is located before it moves toward its point of final destination.

3. The reason for these out-of-line hauls will be understood by a brief review of the tap-line cases. In *The Tap Line Case,* 234 U. S. 1, 28, 29, the Supreme Court of the United States held that a tap line, of the character of the two lines here involved, is entitled to divisions out of the line rate in this territory as compensation "for what it actually does" in performing transportation covered by the through-line rate, but the court said:

> It is doubtless true, as the Commission amply shows in its full report and supplemental report in these cases, that abuses exist in the conduct and practice of these lines and in their dealings with other carriers which have resulted in unfair advantages to the owners of some tap lines and to discriminations against the owners of others. Because we reach the conclusion that the tap lines involved in these appeals are common carriers, as well of proprietary as non-proprietary traffic, and as such entitled to participate in joint rates with other common carriers that determination falls far short of deciding, indeed does not at all decide, that the division of such joint rates may be made at the will of the carriers involved and without any power of the Commission to control. That body has the authority and it is its duty to reach all unlawful discriminatory practices resulting in favoritism and unfair advantages to particular shippers or carriers. It is not only within its power, but the law makes it the duty of the Commission to make orders which shall nullify such practices resulting in rebating or preferences, whatever form they take and in whatsoever guise they may appear. If the divisions of joint rates are such as to amount to rebates or discriminations in favor of the owners of the tap lines because of their disproportionate amount in view of the service rendered, it is within the province of the Commission to reduce the amount so that a tap line shall receive just compensation only for what it actually does.

In conformity with this decision of the Supreme Court the Commission on July 29, 1914, entered an order in *The Tap Line Case,* 31 I. C. C., 490, requiring the defendant trunk lines, one of them being the St. Louis, Iron Mountain & Southern Railway Company, now the Missouri Pacific Railroad Company, to reopen through

routes and publish joint rates to interstate destinations with each of the tap lines parties to the record with which they respectively joined. The Prescott & Northwestern and the Ouachita & Northwestern were both parties to the record. The two paragraphs of the order following this requirement were these:

Provided, That the allowances, or divisions out of such joint rates to be paid by the said principal defendants, respectively, to the said parties to the record on lumber and forest products shall not exceed the amounts hereby fixed as maximum allowances or divisions thereon until further order, the Commission finding upon the record that any allowances or divisions in excess thereof result in undue preferences and unjust discriminations, and are unlawful.

It is further ordered, That the allowances or divisions out of the rates on interstate shipments of lumber and forest products from points on the lines of the above-named parties to the record shall not exceed the following amounts, namely: For switching a distance of 1 mile or less from the junction, $2 per car; over 1 mile and up to 3 miles from the junction, $3 per car; on shipments from points over 3 miles and not more than 6 miles from the junction, 1½ cents per 100 pounds; over 6 miles and not more than 10 miles from the junction, 2 cents per 100 pounds; over 10 miles and not more than 20 miles from the junction, 2½ cents per 100 pounds; over 20 miles and not more than 30 miles from the junction, 3 cents per 100 pounds; over 30 miles and not more than 40 miles from the junction, 3½ cents per 100 pounds; over 40 miles from the junction, 4 cents per 100 pounds.

On April 7, 1919, the Commission entered a fifth supplemental order, effective June 1, 1919, increasing these maximum divisions as follows:

For switching a distance of 1 mile or less from the junction, $2.50 per car; over 1 mile and up to 3 miles from the junction, $3.50 per car; on shipments from points over 3 miles and not more than 6 miles from the junction, 2 cents per 100 pounds; over 6 miles and not more than 10 miles from the junction, 2½ cents per 100 pounds; over 10 miles and not more than 20 miles from the junction, 3 cents per 100 pounds; over 20 miles and not more than 30 miles from the junction, 3½ cents per 100 pounds; over 30 miles and not more than 40 miles from the junction, 4 cents per 100 pounds; over 40 miles from the junction, 4½ cents per 100 pounds.

If, then, divisions may lawfully be based upon the out-of-line haul described, the Prescott & Northwestern should now receive

3.5 cents per 100 pounds out of the through rate for hauling carloads of lumber from Prescott to Tokio, and the Memphis, Dallas & Gulf a further division for its haul from Tokio to Nashville, the Missouri Pacific receiving the balance for its haul from Nashville through Prescott to final destination. Upon a standard carload of 60,000 pounds, the division paid to the tap line would thus equal $21 per car, without allowing for the further amount paid to the Memphis, Dallas & Gulf. On the other hand, if the car were delivered by the tap line direct to the Missouri Pacific at Prescott, the Prescott & Northwestern would receive but $2.50 per car, and the balance of the through rate would be received by the Missouri Pacific for a haul to destination 40 miles shorter than it would be required to perform in the former case. The out-of-line haul in that case, aggregating 76 miles in all, is entirely unnecessary and the only reason for it is to increase the earnings per car of the tap line.

The situation is similar in the case of the Ouachita & Northwestern, where the car returns to the station at which the traffic originates. Thus a car moves from Clarks to Standard on the tap line, a distance of 10.5 miles, and is there delivered to the Missouri Pacific; it then is returned to Clarks and thence moves to destination. Traffic originating at Standard is delivered by the tap line to the Missouri Pacific at Clarks, whence it is hauled to the south through Standard by the latter company. Such movements are wholly wasteful; they do not advance the traffic on its journey nor constitute any necessary part of the transportation from the point of origin to the point of destination. The tap line would be allowed for this useless 10.5-mile haul between Clarks and Standard, on the present mileage basis, 3 cents per 100 pounds or $18 per standard car, shrinking the receipts of the line carrier $15.50 per car and imposing upon it also an additional and unnecessary haul of 10.5 miles.

The Missouri Pacific and the other trunk lines in the territory in question are now under federal control, and it is our understanding that the wasteful practices described above have been abandoned for the time being. The joint tariffs providing for these roundabout routes, however, are still in force, and when federal control ceases the former practices may be resumed. Under the circumstances, we feel that we ought not to allow the situations developed in connection with this proceeding to go without comment, or to omit to state the interpretation, so far as it affects

such situations, which we place upon our orders of July 29, 1914, and April 7, 1919.

A tap line is entitled only to just compensation for the actual and reasonably necessary services performed by it as a part of the transportation of the traffic from point of origin to destination, and our orders relative to divisions out of the through rates were framed upon this principle in conformity with the decision of the Supreme Court already mentioned. The validity of the order of July 29, 1914, was in all respects sustained in *O'Keefe* v. *United States*, 240 U. S., 294. [1] The out-of-line hauls above described are entirely unnecessary, can not reasonably be considered a part of the service for which the through rates are intended to compensate, result in undue prejudice to tap lines and their proprietary companies which are not so situated that they can resort to similar practices, and unjustly deplete the revenues of the trunk line.

A somewhat similar situation was considered in *Louisiana & Pine Bluff Divisions*, 40 I. C. C., 470, where it was held that an out-of-line or diverted movement to a track scale may not be included in computing the distance, under our order of July 29, 1914, upon which the division that a tap line may receive is to be determined, and this decision was recently affirmed upon reargument in *Louisiana & Pine Bluff Divisions*, 53 I. C. C., 475. As was stated in the original report in that case:

> Were we to lend our approval to any such arrangement not only would the Pine Bluff be placed in a more advantageous position than any other tap line in this territory performing a similar service, but such a ruling would open the way in the case of many tap lines for a relocation of their track scales so as to require a long back haul, and in that way to lay a basis for divisions or allowances very materially in excess of those fixed by the Commission for the distance covered by a direct movement from the mill to the junction.

By the same reasoning we conclude that the distances from the junctions which are determinative of the maximum divisions that the Missouri Pacific Railroad may lawfully pay, under our orders of July 29, 1914, and April 7, 1919, to the Prescott & Northwestern Railroad Company and to the Ouachita & Northwestern Railroad Company out of the through rate on interstate shipments of lumber and forest products from points on their lines must be

[1] This case is explained in Vanderblue and Burgess, p. 82n.—Ed.

measured by the direct route of movement toward final destination, rather than by out-of-line movements of the character in question.

2. The Construction and Repair of Equipment [1]

By the Commission:

This is an investigation, instituted upon our own motion, to determine whether, as has been charged, common carriers by railroad subject to the interstate commerce act have caused and are causing certain of their locomotives and other equipment to be constructed and repaired at construction or repair shops other than their own, and have purchased and are purchasing from or through such shops material and supplies used in such construction and repair, at costs in excess of those for similar construction and repairs in their own shops, including material and supplies therefor, in disregard of efficient and economical management, resulting in unreasonable expenditures, and otherwise contrary to law. A hearing has been had with reference to repairs to locomotives of the Pennsylvania Railroad Company, hereinafter spoken of as respondent, and this report relates only to that matter. The term respondent is also used to denote the Pennsylvania lines during federal control.

Federal control ended at midnight February 29, 1920, and the corporate owners thereupon resumed control and operation of their lines. March 10, 1920, respondent entered into a contract with the Baldwin Locomotive Works, Philadelphia, Pa., for the repair by the latter of 200 locomotives then or theretofore in service on respondent's lines; and that contract and its incidents are reviewed at length in the evidence. Respondent has long maintained, at various points on its lines, shops for the repair of its locomotives, and the questions for consideration present themselves as follows: (1) The justification for having the work done in outside shops; (2) the cost of the repairs so made as compared with the cost had the work been done in respondent's shops; and (3) the providence or improvidence of the particular contract and of settlements thereunder.

June 30, 1920, in response to our circular letter of inquiry, respondent's vice president in charge of operation submitted the following explanation of the award of the contract:

[1] *Construction and Repair of Railway Equipment, Pennyslvania Railroad Company*, 66 I. C. C. 694 (March 7, 1922).

In reply to the last paragraph of your letter, would say that on March 1st, last, all available shop space on the Pennsylvania System was filled with locomotives undergoing repairs and 666 locomotives were out of service awaiting shop. It was evident also that our facilities and the available force would be required to care for locomotives in service on March 1st, but which would require general repairs within the six succeeding months. In order to relieve this congestion and have the power returned to service as soon as possible, a contract was made with the Baldwin Locomotive Works to repair 200 of our heavy type freight locomotives.

The evidence in respondent's behalf was adduced by its chief of motive power.

As a general outline of the situation, respondent's witness submitted, in substance, the following: Early in March, 1920, he found on the system a shortage of locomotives and cars to meet the demands of shippers, and, having already accepted all contracts holding over from the Railroad Administration, let two other car contracts and the locomotive contract in question. . . .

The witness testified that the Baldwin contract did not contemplate any reduction in respondent's shop output, it having been estimated that the full capacity of those shops would be required in addition. It might be inferred from his testimony that the consideration which immediately led to the contract was that, according to his figures as of the end of federal control, 261 locomotives were then undergoing class repairs, 340 were awaiting such repairs, and 724 were due for them a month later, with an accompanying pressure for motive power to handle the volume of traffic. His insistence that the repairs could not have been made without increasing respondent's shop facilities was amplified by the statement that most of the shops were working double shifts and that the "controlling machines were up to their capacity, in three tricks in most cases."

The contract was on a cost-plus basis, that is, the cost of materials, at stipulated prices, and of direct labor, plus 90 per cent of the distributed labor cost to cover all overhead expense, plus 15 per cent of the whole for profit. All scrap material resulting from the work was to become the property of the Baldwin plant, and respondent was to bear all freight charges on materials and on the completed locomotives. Deliveries to respondent were to be made within three to four months after receipt of the first locomotive at the Baldwin plant, barring certain contingencies; and in fact commenced in April and ended in September.

The aggregate cost of the repairs under the contract, upon final audit, is stated by the witness to have been $4,496,820. This figure, however, does not include the cost of inspection in that connection, represented by a force of 32 inspectors kept by respondent at the Baldwin shops for that purpose during the contract period and whose maintenance was chargeable wholly to the repair work. . . .

Briefly, respondent bases the claimed necessity for invoking the aid of the Baldwin plant upon the condition of its motive power at the end of federal control, the inadequate capacity of its own shops for making the requisite class repairs, and the then existing and prospectively increasing volume of traffic. Of the array of figures and other data introduced by the several witnesses, apart from some irreconcilable conflicts in the evidence, much is without probative value in respect of the real questions. The only practicable means of determining the issues seem to lie in comparisons of conditions, performances, and results, using such factors as the record affords; and as but portions of the available material go back of the period of federal control, the years 1919 and 1920 will be taken for the purpose.

At the outset the matter of ascertaining whether the 200 locomotives could have been repaired in respondent's own shops, giving consideration to conditions which obtained at the date of the Baldwin contract, is complicated by respondent's widely varying statements of the capacities of its shops for class repairs and by the testimony of its witness that those indicated capacities depend materially upon the heavy running repairs the shops are called upon to make. While testifying that such running repairs are more or less frequently made in the shops, and that in some degree class repairs are made in the roundhouses, he could give no estimate of the extent of these interchanges. . . .

Concerning the condition of motive power and the outlook for its rehabilitation at the end of federal control, respondent stresses the then estimate of 724 locomotives to fall due for class repairs in one month's time, together with a total of 601 locomotives then in and awaiting shop for such repairs according to one of its exhibits and 540 according to another. The first exhibit also shows 670 locomotives estimated, as of the last day of the preceding month, January, to be due for class repairs after a month's further service, together with a total of 463 then in and awaiting shop according to the same exhibit and a total of 413 according to the other. It was

admitted that such estimates necessarily are uncertain, and it appears that of the 724 particular locomotives referred to but 253, and a total of but 479 from all sources, were taken out of service by the end of the ensuing month. Indeed, during the months of February to June, 1920, inclusive, an average of but 490 locomotives was taken out of service for class repairs, including the 200 sent to the Baldwin plant. Viewing the situation from another angle, as of the end of February, 1920, the estimate also included the locomotives expected to fall due by successive monthly periods up to 12 or over; and, taking the figures shown for the first six months, the average would have been a fraction in excess of 536, assuming the estimates to have been dependable. . . .

Respondent rightly contends that the expediency of the Baldwin contract must be considered in the light of the contemporaneous and prospective volume of traffic, which, according to the event, is shown in loaded freight car-miles and in locomotive-miles operated. The latter is relied upon by respondent, the following table of locomotive mileage exhibited by it contrasting the 1919 and 1920 performances by months:

Month	1919	1920	Month	1919	1920
January.........	17,258,092	17,468,082	July............	17,089,513	18,444,533
February........	13,979,449	16,061,738	August..........	17,403,519	18,654,808
March..........	14,760,462	18,797,164	September.......	17,435,710	18,111,180
April............	14,409,096	13,933,908	October.........	17,992,010	18,180,905
May............	15,664,145	16,701,671	November.......	15,871,392	17,402,661
June............	15,843,878	17,467,441	December........	16,857,075	17,743,598

It will be observed that in each month of 1920, save April, when the so-called outlaw strike occurred, the locomotive mileage exceeded that for the corresponding 1919 period; and, perhaps curiously, substantially the same rate of increase appears in November and December, 1920, after the business depression had manifested itself. The mileage for the entire year 1920 was 7.4 per cent greater than for 1919. Among other details, the tabulation discloses an 8 per cent decrease in February, 1920, as compared with the preceding month, and a more pronounced corresponding decrease in 1919. January, 1920, increased 1.2 per cent over January, 1919, while for the months of February the 1920 increase over 1919 was 14.9 per cent. Not so separated, and looking at the figures as indicating the comparative traffic trend from the beginning of the year up to the time of the contract, the mileage

for the first two months of 1920 showed an increase of 7.1 per cent over the corresponding period of 1919, or slightly less than the percentage increase for the full year.

The traffic situation also is illustrated by an exhibit showing the loaded freight-car mileage from September, 1913, to March, 1921, inclusive, submitted by respondent at the request of the interveners and according to which the first two months of 1920 exceeded the corresponding 1919 period by 7 per cent.

In turn, the foregoing performances should be considered in the light of other and related factors, more especially motive power availability. The relationship may first be tested by the indicated available locomotive service months, although based upon evidently more or less inaccurate estimates, upon the assumption that one period's errors may approximate another's. At the end of January, 1919, the available service months were 43,990 and were 48,793 at the corresponding time in 1920, an increase of 10.9 per cent. At the end of February, 1919, they were 42,604, and at the corresponding time in 1920 were 46,266, an increase of 8.6 per cent. While the estimates for successive months naturally are not cumulative, the average of the percentage increases in the first two months of the respective years was 9.75, or somewhat greater than the percentage increase in the locomotive mileage for same periods. There was a decline in the percentage rate of increase in February as against January, but, as expressed in percentages of increase, the showing for the available service months still was better than that for the locomotive-miles operated.

A further indication of what might have been accomplished may be found in the fact that at the end of March 1919, the available service months were 42,109, the lowest shown in 1919 or 1920, and by about the end of August, 1919, were brought up to 52,473, an increase of 24.5 per cent, during which period the locomotive-miles operated increased 8.3 per cent, the maximum mileage attained approximating the average mileage for the years 1919 and 1920 combined.

Again, as against 711 locomotives in and awaiting shop for class repairs, and a total of 1,397 in and awaiting shop for all repairs requiring 24 hours or over, at the end of federal control—the highest of the figures shown of record—there were 785 locomotives in and awaiting shop for class repairs and a total of 1,390 so due for all repairs at the corresponding time the previous year; and the

1919 situation was relieved in the company shops in a few months, with a concurrent rising tide of traffic. Otherwise stated, as against about 18 per cent of the motive power out of service at the end of federal control, with an upward trend of traffic—admittedly reaching the danger point—something like 22 per cent of power out of service in 1919 was reduced to about 12 per cent by respondent's facilities, with an accompanying traffic increase.

A further contention is that the invocation of outside aid was justified by the event, in which connection respondent cites its inability to furnish cars during the summer of 1920 and to illustrate which it exhibits the cars requisitioned and furnished and the lay-over of cars in yards for the last 10 months of the year. But nothing is offered to attribute the situation to motive-power conditions, without regard for the many other matters that might affect that situation, such as the "outlaw strike" which aided in bringing the April lay-over up to 91.9 per cent, the highest shown. The lay-over for March approximated that for the entire year; and, whereas it was stated that "anything over 50 per cent represents abnormal conditions," it is of interest that from July to December, inclusive, the lay-over exceeded that percentage and that during each of those months respondent made reductions in its shop and roundhouse forces, in all a very considerable number. At the same time, fully conceding the necessity for maintaining the motive power then and at all times, the real question is, whether respondent could have done the repair work in its own shops.

It is not questioned that the cost of the contract work exceeded that for which the work could have been done in respondent's shops, assuming the adequate capacity of the latter. The investigators compute the excess cost, including the pay of the 32 inspectors, deducting additions and betterments made at the Baldwin plant, and making certain other appropriate adjustments, including an allowance for overhead expense, to have been $3,173,982.33, a little less than the total indicated by respondent's figures. Respondent secured no other bids for the work, and the possibility of obtaining the repairs at other contract shops at a lower cost can not be determined.

Respondent's records indicated that, of the 200 locomotives in question, 5 received class-2 repairs, 153 received class-3 repairs, 3 received class-4 repairs, and 39 received class-5 repairs. A check of the repairs actually made, however, disclosed that 44 locomotives shown as having had class-3 repairs in fact received

class-4 or class-5 repairs, although this does not mean that respondent paid class-3 prices therefor. The check also indicated that the Baldwin repairs and those concurrently made in respondent's shops were comparable in character.

To a criticism that respondent paid twice for some of the repair work defectively done in the Baldwin shops in the first instance and there replaced or corrected, respondent answers on brief that the payments were in strict conformity with the contract, and adds the comment that it would be interesting to know if the representatives of the Commission think that in like circumstances the railroad should make a deduction from the wages of its employees. The comment is wholly beside the question, especially as the payments to Baldwin were not in fact in accordance with the terms of the contract. That instrument provided, as before stated, for the addition of 90 per cent of distributed labor to cover all overhead expenses, including "rentals, . . . errors or defects," etc.

Weighing one thing with another, the record indicates to us that at best respondent was precipitate in resorting to outside shops, at an added expense of more than $3,000,000, almost immediately upon its resumption of its property. It is obvious that every consideration of good management dictated the restoration of the locomotives, with earning capacities ranging upward of $12,000 to $17,000 monthly, to a serviceable condition without undue delay, but the same considerations also dictated the accomplishment of that end without unnecessary expenditures. Upon a careful review of the record we conclude that a more thorough survey of respondent's facilities in the light of past demands and performances would have disclosed a capacity to do the work itself within a reasonable time by an appropriate coordination of efforts and by such added exertions as relieved the situation in the preceding year. The interveners' imputation to respondent of an ulterior or dishonest motive has no support in the record.[1] . . .

EASTMAN, *Commissioner*, concurring:

While I am in general agreement with the report of the majority there are certain matters upon which more emphasis might well be laid, and to these I wish to direct attention. The fact disclosed by the investigation which is of chief public interest, it

[1] The interveners were the railway employees department, American Federation of Labor, and affiliated organizations.—Ed.

seems to me, is the discrepancy between the cost of the contract work done in the Baldwin shops and the cost of precisely similar work done in respondent's own shops.

In this proceeding respondent has disclaimed any contention that its employees were inefficient. Nevertheless the work in its shops during 1920 was carried on under the so-called national agreements, entered into during federal control, which have so frequently been criticized as resulting in burdensome and uneconomical working conditions. Yet we find, using respondent's own figures, that the cost of the same class of repairs on a certain type of locomotive was $9,453 at its own shops as compared with $25,799 under the Baldwin contract, an excess for the latter of 173 per cent, without including the cost of the 32 inspectors stationed by respondent at the Baldwin shops during the contract period. For another type of locomotive the cost of the same class of repairs was $9,989 at respondent's own shops and $21,692 under the Baldwin contract, an excess for the latter of 117 per cent. These figures include such allocation of overhead expense to the cost of the work at its own shops as respondent deemed proper in order that the two sets of figures might be fairly comparable. Our own accountants, after an analysis of the records, reached the conclusion that the excess cost of repairing the 200 locomotives under the Baldwin contract as compared with the cost of doing the same work in respondent's shops was more than $3,000,000, or more than $15,000 on the average per locomotive.

Lest it be thought that the discrepancy was in any measure due to heavier work, class for class, at the Baldwin plant than in respondent's shops, it may be said that such a claim was made, but our check of the records showed it to be without basis. Nor was the discrepancy due solely to any difference in necessary overhead expense, for on the contrary it appears to have been due primarily to a difference in labor costs. Our accountants found that the time consumed in making the repairs at the Baldwin plant, over and above the time required for similar repairs at respondent's own shops, was more than 36 days per locomotive. They also found that the labor excess at the Baldwin plant was 93 per cent for class-2 repairs, 140 per cent for class-3, 152 per cent for class-4, and 137 per cent for class-5 repairs. Indeed, the only justification offered for the excess cost which seems to have possible merit is that the Baldwin plant was not experienced in or well equipped for repair work, an explanation which I find it diffi-

cult to believe can account in any large measure for the extraordinary discrepancy disclosed, especially if there be any foundation whatever for the criticisms which have so frequently been offered with respect to the national agreements.

But this discrepancy in cost is not the only startling thing about the Baldwin contract, for the contract itself and the manner in which it was interpreted are startling. It appears that no competitive bids were sought and that the contract was made on what has come to be known as the "cost-plus" basis. That is to say, the charge was based on the cost of materials and labor, plus an arbitrary 90 per cent of the labor cost to cover all overhead expense, plus an arbitrary 15 per cent of the whole for profit. It further appears that the 90 per cent of the labor cost to be added for overhead was to include "errors and defects." Notwithstanding this provision, in hundreds of cases where, because of errors or defects, it became necessary to do the work a second time, respondent paid for the work entailed in remedying the error or defect, and this labor cost was included in computing the 90 per cent for overhead and the 15 per cent for profit.

I base this statement upon a letter placed in evidence from one of respondent's assistant motive-power accountants to his superior officer, reading in part as follows:

> In connection with the Baldwin contract there are hundreds of cases where the work was done the second time, which I presume we will have to pay for, since the money was actually paid out and the work actually performed, * * * .

At the bottom of this letter was a penciled memorandum from the superior officer reading in part thus:

> As I see the matter we will have to pay Baldwin for all work they did on those locomotives, even though it may have been done twice due to the inefficient methods of handling the work.

No evidence was submitted in any way controverting these statements, nor was it denied that this was the construction placed by respondent upon the contract.

In other words, as I understand it, it is conceded, not only that respondent let the contract without competitive bids, but also that it agreed to an interpretation of the contract which made it possible for the Baldwin company actually to profit by negligent or inefficient work. The more of such work that it did the greater

the amount of its 90 per cent for overhead expense and the greater the amount of its 15 per cent for profit.

I submit that these are important facts for the public to know. If our great railroad companies are at such a disadvantage in dealing with outside supply companies that they must agree to arrangements of this nature, it lends force, among other things, to the suggestion recently made by the National Association of Owners of Railroad Securities that much expense could be saved if the railroad equipment of the country were pooled and all repair and construction work handled through centralized agencies. The facts so disclosed also make me unwilling to subscribe to the statement of the majority with respect to respondent's motives in the premises. I do not understand that motives were under investigation and no finding, therefore, upon this matter is appropriate. But if it were our duty to make such a finding, I confess that the evidence has not left me free from doubt as to what the finding should be.

The dissenting opinions object to the conclusions of the majority, if I read them aright, on three principal grounds:

(1) That we are exceeding our lawful authority in making the investigation.

(2) That from the meager and "incomplete" record an intelligent conclusion can not be derived, and even if such a conclusion could be reached, we are not competent to reach it.

(3) That in any event the conclusion which the majority have reached is wrong.

Taking up these points one by one, it may be noted that the investigation was instituted on January 3, 1921, by unanimous vote of the Commission. Our authority to make such an investigation was not then questioned. The equipment-repair contracts of respondent and other carriers had become the subject of discussion, not only throughout the country, but in the Halls of Congress. It was desirable that the facts should be known, and it was particularly desirable because, during much of the life of these contracts, the United States was the guarantor of railroad income. The facts which I have set forth at the beginning of this opinion are in themselves sufficient justification for the investigation. If we are without power to obtain and make public such facts, it would be the duty of Congress to confer power upon us. But I entertain no doubt as to our authority; it has not been questioned by any of the respondent carriers.

The record of the investigation is far from meager. Respondent was given opportunity to present all the evidence that it desired to present, and it took ample advantage of the opportunity. As for our competency to pass upon this evidence, I concede that we are not expert railroad operators, but neither are we expert railroad traffic officers or accountants or engineers or financiers. Yet we pass upon rate, accounting, valuation, or financial matters every day. If it were necessary for judges or juries to be experts in the subject-matter of every lawsuit, what would become of our courts? The theory of any judicial investigation or proceeding is that those who are expert will be able to impart their knowledge, so far as it pertains to the question at issue, and that those who sit in judgment will be able to weigh the evidence so presented. We are as able to weigh the evidence in this proceeding as we are in many of the other complicated and technical cases upon which we are continually obliged to pass.

Coming, then, to the conclusion of the majority, "that a more thorough survey of respondent's facilities in the light of past demands and performances would have disclosed a capacity to do the work itself within a reasonable time by an appropriate coordination of efforts and by such added exertions as relieved the situation in the preceding year": Whether or not this is true is a matter of much less importance, as I view it, than the disclosure of the facts respecting the cost which respondent was obliged to meet under the contract and its interpretation of that contract. I also agree with the dissenting opinions that the necessity of outside contract work is a matter to be judged in the light of the situation by which respondent was confronted, or thought that it was confronted, at the time when the contract was made. Subsequent events are pertinent only so far as they throw light upon conflicting or doubtful evidence as to the facts at that time.

Nevertheless, I agree with the conclusion of the majority. Of particular significance, it seems to me, is the evidence with respect to the capacity of respondent's shops for repair work. In 1918, when it was necessary to secure accurate data from the railroads as to this capacity in view of war necessities, the officials then in charge of respondent's shops advised the Railroad Administration and advised us that the monthly capacity for classified repairs was 627 locomotives. In January, 1921, however, after this investigation had been instituted, respondent reported this capacity as 580 per month. Yet during federal control the Railroad Adminis-

tration made capital expenditures on respondent's shop buildings, shop machinery and tools, engine houses, etc., totaling $20,822,993. Moreover, at the hearing respondent placed the capacity at a maximum of 525 per month, on the ground that unclassified repairs might interfere with the output of classified repairs. The evidence, however, does not show that at the time the contract was made respondent had reason to anticipate an abnormal load of unclassified repairs. On the contrary, the record does show that the monthly average of classified and unclassified repairs in 1920 was 4,432, as against 6,682 in 1919, 5,867 in 1918, and 4,482 for the last 10 months of 1917. The pressure of unclassified repairs in 1920 was manifestly lighter than in the other years, and this was true of the months immediately following the resumption of private control. The monthly average of such repairs, according to respondent's own figures, was 4,707 in the first six months of 1920, as compared with 7,103 in the corresponding months of 1919. I am unable, therefore, to accept the statement that the maximum capacity of respondent's shops for classified repairs at the time the contract was made was but 525 per month.

Of significance, also, is respondent's estimate that on February 28, 1920, there were 724 locomotives in service which were good for but one month's service, when it is considered in the light of the fact that on March 31 it was found that only 253 of these locomotives had been taken out of service, that 168 were good for another month's service, 35 for two months, 40 for three months, 46 for four months and 174 for five or more months. Granted that estimates of this character are necessarily inaccurate, I think it is a fair conclusion, in view of the very large element of error, that the estimate of February 28, 1920, was not thoroughly or carefully made.

I am further impressed by the fact that the evidence indicates that motive-power conditions were substantially better in February, 1920, than in the corresponding month of the previous year. There was, for instance, an increase of 8 per cent in locomotive service months available. It is true that present and prospective traffic were heavier in February, 1920, than in February, 1919; but in the summer of 1919, when traffic began to grow heavy, the evidence shows that the Railroad Administration was able, without seeking outside assistance, by concentrated effort to effect a very marked improvement in a comparatively short time. The record shows that at the end of March, 1919, the number of loco-

motive service months available was less than at any time in 1919 or 1920. Yet by the end of August, 1919, the number had increased to a point higher than at any time in either year.

In one of the dissenting opinions, the statement is made that "during the first six months of 1920 the shops were working to full capacity and working overtime." As a matter of fact there is no convincing evidence that there was any considerable amount of overtime work. It clearly appears that the men in the shops, during this period, were not put on 9-hour shifts, and, indeed, that this means of relieving the situation was not even considered. Moreover, the statement that the shops were working to "full capacity" is inconsistent with the testimony that during this period respondent was in need of, and was continually seeking, additional men for its shops. Mr. Wallis testified that in most cases his controlling machines were worked to capacity. Yet the record shows that at the same time respondent claims to have been making diligent efforts to increase its shop forces.

Finally, I am impressed by the fact that, while traffic over the Pennsylvania continued to be heavy to the end of the year 1920, in July of that year respondent felt free to reduce its shop forces materially, and this reduction continued throughout the fall.

POTTER, *Commissioner*, dissenting:

At the end of federal control the Director General turned back to the respondent a large number of bad-order locomotives at a time when great increase of traffic was in prospect. Faced with the serious consequences of a shortage of power, the respondent, on March 10, 1920, in order to make repairs more rapidly than they could be made in its own shops, contracted to have 200 of its 7,300 locomotives repaired in the best outside shops available. The majority report finds that later this decision was found to be a mistake; that the locomotives could have been repaired in the respondent's own shops by the time they were needed and at a lower cost than the amount paid for the outside work. This alleged mistake of judgment is the sole basis for the criticism which the majority report makes. The good faith of the officials of the respondent is not questioned, and they are completely exonerated by the majority report from every improper motive.

As there is no finding of bad faith the promulgation of our report raises very serious questions as to the function and power of this Commission. I deplore the taking on of work which I believe

is not intended for us. The duty of this Commission to consider the limitations upon its authority is of such vital importance to the public, if our system of regulation is to endure, that I think we can well afford to discuss it in the forum of our reports.

We can arrive at a just conclusion only by putting ourselves in the position of the managing officials on March 10, 1920, when they contracted for the outside work. It is a manager's duty to do the thing which his judgment, based on his knowledge and experience, at the time he is called upon to act, suggests that he should do. For him, that decision is right and free from criticism for all time which seems right when made, no matter how it turns out later. What would we have done if we had been in his place, with his perplexities, doubts, and forebodings, is the only fair and proper question for us to consider. If the inquiry before us were thus limited, as obviously it should be, there is not in the record any basis for criticism. In fact, the majority report seems to admit this, for the main reliance of the majority report is upon testimony, not as to the conditions which actually confronted the officials when they made their decision, but as to conditions and happenings later. If later it had turned out (which it is shown it did not) that the work could have been done at home, it by no means would follow that the March decision was not the correct decision for March. Upon the question as to what was the proper decision in March, with March prospects, uncertainties, and fears, testimony as to what were subsequent realities and certainties was incompetent and immaterial. Its receipt and consideration in this case did violence to essential rules of evidence, law, and justice, which we should observe.

In working toward a conclusion we are bound to accept the facts that the chosen representatives of the stockholders and directors of the respondent, brought up in its management, recognized throughout the transportation world as men of high skill, charged with the responsibility of managing its affairs, acting in good faith in accordance with their judgment, decided it was best to send this work out. I can not see that we are charged with any duty or responsibility which requires us to review their judgment, or that we have any authority to do so. We are not competent to review it. These officials understood the needs of their company as we can not. They understood the territory they served, and its commercial and industrial conditions, and the probabilities of tonnage as they existed when it was decided to send the work out.

They understood their shops and forces and knew, far better than we could, how to handle their labor. No one knew what might happen at almost any minute, and the best preparation was required at every point. If they felt it was necessary to make their company independent and strong in the face of what threatened, or that it was good policy to build independent resources, free from outside interference, we have no right to say that, from the standpoint of company policy or of public interest, their conclusion was wrong. The responsibility was theirs. We should not reverse their judgment upon a record made at this late date, which, in the nature of things, can not possibly give us even an outline sketch of the picture which confronted them.

We must remember that the steam locomotive is the heart of American industry, without which railways can not operate and industry, in a broad sense, can not be carried on. There are about 70,000 locomotives in the country. Each one of these locomotives is responsible for its part of the transportation of the nation, of the successful operation of the industries of the nation, of the supply of food for the nation, of the furnishing of employment to all the millions of laborers. Almost it might be said that upon each one of these locomotives depends one seventy-thousandth part of the prosperity of the nation and the protection of the nation's property, peace, and order. The value to the nation of one month's service of a locomotive in busy times, is worth far more than the cost of the locomotive itself. There is never an excuse for any carrier to run any risk with respect to its motive power. The vital and universal need of all important industries in this country is transportation. Transportation facilities are idle and investments in them are wasted in the degree that power fails. Chance may be taken with cars, and all other things, but never with locomotives. We will perform our best service only if we make this clear. The one thing that never should be excused in a manager is avoidable risk regarding the effectiveness of his motive power. Particularly in times of stress he should not stop to make close estimates or draw fine distinctions as to how or where repairs should be made or as to relative cost. He should consider first how to be absolutely certain under every possible contingency to have his power ready.

We are equipped for regulation within the law, regarding rates and other matters clearly within our proper function and with which continually we are called upon to deal. We are not equipped

for problems of management and operation. These are beyond the lines that define our field. The idea that we, a commission of 11 men, brought from different walks, none of whom was selected because he had any knowledge regarding practical railway operation, can, in spite of our inexperience, two years after the fact, on an incomplete record of conditions, put ourselves in the chair of the general manager or master mechanic of the largest system of railroads in the United States, and say how, in perilous times, he should have handled a very difficult operating problem, and justly criticize him for error, does not find favor with me.

We have been given no roving commission to investigate and criticize. Federal control ended at midnight, February 29, 1920, and under the law in effect since then the carriers are to be managed by the chosen representatives of their owners and not by us.

The Supreme Court of the United States in *Interstate Commerce Commission* v. *C. G. W. Ry. Co.*, 209 U. S., 108, at page 118, said:

> It must be remembered that railroads are the private property of their owners, that while, from the public character of the work in which they are engaged, the public has the power to prescribe rules for securing faithful and efficient service and equality between shippers and communities, yet, in no proper sense, is the public a general manager.

We are not making any order upon our report and are giving no direction and we have no authority to do either. Our report is only criticism of management where responsibility for management is not on us. No complaint of violation of the law has been made, and we have found no violation. In such a situation I see no right to interfere with criticism and disturb and irritate with expressions of our opinions. If the officers of the respondent have not exercised good judgment, they are accountable to its stockholders, and not to us. . . .

The procedure we have adopted in making this inquiry can not be supported by the provisions of the transportation act under which honesty, efficiency, and economy of management are to influence the determination of rate scales. We have not proceeded as in a rate inquiry for rate-making purposes. Our report can be of no service for rate-making purposes. It determines nothing respecting the honesty, efficiency, or economy of respondent's management. It deals only with one transaction that occurred two years ago in one branch of carrier operation. A mistake might have been made in this matter and yet the respondent might be

the most efficiently operated carrier in the country. There might be warrant in conducting a general inquiry as to carrier efficiency shown by the respondent's operations generally, but the discussion of an isolated transaction under unusual conditions can not be helpful to us on any question we have jurisdiction to determine.

This is one of several investigations we are carrying on of a similar nature and under similar circumstances regarding different carriers throughout the country. They are taking an enormous amount of precious time and are costing many thousands of dollars—without accomplishing any result of the slightest value to anyone.

Criticism of a transaction in a particular situation can do no good. It may do harm. No helpful lesson is to be learned from our action. If in the future the officials again should be confronted with what seems to them an emergency situation and they recall our criticism in the present case, they would do one of two things—either disregard our criticism and boldly go ahead and do what they thought they ought to do, as they should, or they would say: "We did what we thought was best before and were reprimanded. Now we will play safe. We will try to repair the locomotives ourselves. If we fail, only the public will suffer. The responsibility will be on the Interstate Commerce Commission and our failure will never be known." To encourage such an attitude and to so dissipate ambition and resolution, as it seems to me might be the effect of adopting the policy of our report, would be unwise. Man efficiency more than anything else determines carrier efficiency. Our job is to increase where we can the efficiency of men. To this end, we should stimulate initiative, courage, and prompt action and a willingness to take on and quickly solve big problems. If railway operating officials, responsible for furnishing transportation for the public needs, are to stop before acting and wonder whether we are going to criticize them or not, the result, as far as the country is concerned, will be far worse than the occasional losses which may occur through the courageous and prompt exercise of judgment.

There has been a full hearing. We have had opportunity to ascertain the facts, and if we have not ascertained them all, it is our fault. In impartial investigation, as well as in prosecution, the burden is upon us all the time to obtain all the facts bearing upon the justness of our conclusion. Our own attorney conducted the proceeding—certainly with all the zeal that impartial investiga-

tion permitted. The intervening labor organizations had vigorous representation before us. After an investigation so made, no suspicion beyond the facts found by us can be entertained. If the record is not complete, our finding stands condemned. The presumption of innocence until proven guilty prevails before us. The greater the official power the greater the duty to respect and guard the private right.

In the foregoing I have dealt with this case without regard to the testimony as to what happened after March 10, 1920. To exclude such testimony seems to me our obvious duty. If it were proper to consider such testimony my study of it convinces me that the majority view involves a misunderstanding of the record, which, to my mind, demonstrates by subsequent events that the contract in question was justified. . . .

Any theoretical or abstract objection to the contract because it was not entered into after competitive bidding, or because of any of the terms which it contained, or of the manner in which the work was to be done or paid for under it, is out of place when coming from us, because we, who made the record, have failed to show that any better terms were available. The burden of the attack was upon us, and it was incumbent upon us to show, by affirmative testimony, that this particular contract was not justified by the conditions under which it was made. We do not know whether any better terms could have been obtained and therefore can not find against what was done. This inquiry respecting the outside repairs made for the respondent is in a proceeding which involves outside repairs arranged for by other carriers. A comparison of the respondent's contract with the other contracts before us does not indicate in the respondent's contract exceptional characteristics justifying criticism. We may not apply abstract theory to such situations. Nor may we indulge in assumptions, implications, suppositions, and presumptions.

Whatever the *actual net cost* of these repairs to respondent may have been, if in fact the earnings of locomotives restored to service were not greater than the repair expenditure, the expenditures were justified from the point of view of the management in March, 1920, when it faced the uncertainties of the coming year. It was not time to hesitate when the public service depended on the amount of available motive power. To have taken chances with the supply of locomotives would have been to gamble at the risk of public welfare. The evidence all goes to show that the de-

cision made had ample warrant in the facts before those who made it and was justified by subsequent events. We have not been erected into a supreme directorate of all the railways of the country, and I conceive that it would be beyond our province and unwise to criticize those who are responsible, even if in the exercise of their judgment we thought an error had been made.

LEWIS, *Commissioner*, dissenting:

I am not in accord with the majority. The cost of repairs under the Baldwin contract undoubtedly was higher than had the work been done in the Pennsylvania's shops. As it transpired, the Pennsylvania could have made the repairs later in the year. These, however, are not the controlling factors. If judgment is to be passed it must be on the question of whether, in March, 1920, the company was justified in sending the work out.

At that time the carriers were facing the return of their properties from government operation. This was a national policy adopted by Congress, approved by the Railroad Administration and by the country. There was general recognition that private operation was then put on final trial. Traffic was heavy. Complaints were general. There were repeated warnings that service must be improved. There was every reason to anticipate the still greater demands which came in the spring, summer, and early fall of 1920. Under all these conditions the company was under obligation to make every effort not only to maintain but to improve its facilities for transportation. Motive power was the vital traffic-moving element. Locomotives in repair had an earning power in excess of $12,000 a month. More important, however, was that on an adequate supply of motive power depended both the success or failure of private operation and the high industrial and commercial activity of the country.

The decline in traffic in the latter months of 1920 could not be foreseen. This Commission in authorizing rates to yield a definite return upon the values of the carriers' properties was unable several months later and after a series of hearings of national scope, to predict the collapse of traffic then only a few weeks distant. I can not, therefore, concur in a condemnation that, in light of a specific finding that no ulterior or dishonest motives were shown, must rest on conditions which arose subsequent to sending the needed locomotives to outside shops. The contract was made without competitive bidding and on the cost-plus basis. How-

ever, it was made in a period made historic by reckless, loose contracting in all business and at a time when the cost-plus contracting system, widely employed by the government itself, had not fallen into discredit.

My objections to the adoption of such a policy are, however, more fundamental.

First: The government has decided against government management of the railroads. It has set up regulation and has definitely adopted a policy of protection. Charges for services may be levied to meet only the requirements of honest, efficient, and economical management. The record does not give warrant for condemnation on the ground of dishonesty or inefficiency. The pressing consideration in March, 1920, was service, and whatever might be said in criticism on the ground of uneconomical management disappears when there is taken into consideration the earning power of locomotives in service.

Second: The adoption of a policy of condemnation is dangerous. The prosperity of the country is dependent on exercise of broadest vision and boldest initiative by those in charge of the railroad facility. Responsibility should not be impaired by intimidation and menace of public censure except in instances of most extreme provocation. Management having been placed, as a national policy, in the hands of the railroad executives, the government should not condemn actions that appear when taken to be to the best interest of all concerned, except upon a conclusive showing of improper motives or public injury.

COMMISSIONERS HALL, DANIELS, and CAMPBELL also dissent.

CHAPTER XVII

SCIENTIFIC MANAGEMENT IN THE OPERATION OF RAILROADS[1]

The most striking feature of the recent public hearings before the Interstate Commerce Commission, in the matter of proposed increases in freight rates, was the charge of railroad inefficiency. Mr. Brandeis's clever turn in attacking the railroads in the quarter where attack was least expected called sharp attention to the subject of railroad management. The public was caught instantly by the dramatic statement that the railroads could save *a million dollars a day* through the adoption of a new system of scientific management, and their lively interest in it was kept up by newspaper and magazine discussion. In getting at the truth, the public had little constructive assistance from the railroads, and their disdainful attitude added to the first effect of the charges. The general impression, therefore, was that the railroads were needlessly deficient.

It is advisable to examine the charge of inefficiency apart from the rate question, which is now settled.[2] It is, perhaps, comprehensible that the railroads, already harried by public attack and suspicion, and now reproached unjustifiably, as they think, should

[1] From William J. Cunningham, *Quarterly Journal of Economics*, vol. 25, pp. 539-562 (May, 1911). Reproduced by permission. The testimony of the various experts, to whom Professor Cunningham refers, appears in *Evidence in the Matter of Proposed Advances in Freight Rates*, Sen. Doc. 725, 61st Cong., 3d Sess.; the opinions of the Interstate Commerce Commission, refusing permission to the railroads to increase their rates are *Advances in Rates—Eastern Case*, 20 I. C. C. 243, and *Advances in Rates—Western Case*, 20 I. C. C. 307. These opinions are discussed, Jones, pp. 252–253, and Vanderblue and Burgess, pp. 105–107.—Ed.

[2] In its decision of February 22, 1911, on proposed advances of rates by carriers in official classification territory, the Commission says: "It is difficult to see exactly what application the Commission can make in this case of this testimony (on scientific management). The witness who apparently had most to do with originating and applying these methods testified that they were in actual operation in not over one-tenth of one per cent of all the manufacturing establishments of this country. The system is everywhere in an experimental stage. To some extent it has been tried and is now being tried by our railways. The representatives of railway labor who appeared before us stated that these methods could not and should not be introduced into railway work. Upon this record, we can hardly find that these methods could be introduced into railroad operations to any considerable extent, much less can we determine the definite amount of saving which could be made. We cannot therefore find that these defendants could make good any part of these actual advances in wages by the introduction of scientific management."

be indignant at being presented with a new pill to swallow. Perhaps they may be pardoned for looking on it as a quack remedy. But it behooves the student of railway problems to examine the new prescription carefully and, so far as may be, impartially to inquire whether the railroads have some justification for distrust, to ascertain if the extent of waste is as great as suggested, to indicate some of the limitations on the adoption of any system of scientific management, and to suggest what may be learned with profit from its advocates.

It is necessary at the outset that we have a clear understanding as to what is meant by scientific management. To obtain it, we will go at once to headquarters. Mr. Frederick W. Taylor, consulting engineer, Philadelphia, is acknowledged as the dean of the efficiency experts and the originator of the new system. Mr. Taylor was conspicuously successful in his management of the Midvale Steel Company, where he was successively laborer, foreman, superintendent, and general manager. There his system was first worked out. In addition, he has also made an international reputation as the inventor of high-speed steel for metal-cutting tools and drills, an achievement in itself sufficient to stamp him as a man of remarkable scientific attainments. The history of the gradual evolution of his system of shop management, his successful efforts to systematize and conserve labor, and the experiments in evolving high-speed steel, reads like a romance.[1]

The fundamental principles of Mr. Taylor's system are definite, and are set forth by him as follows: [2]—

First. Each man in the establishment, high or low, should daily have a clearly defined task laid out before him. This task should not in the least degree be vague or indefinite, but should be circumscribed carefully and completely, and should not be easy to accomplish.

Second. Each man's task should call for a full day's work, and, at the same time, the workman should be given such conditions

[1] The writer attended Mr. Taylor's several lectures before students in the Graduate School of Business Administration, Harvard University. He has also seen the practical application of the new system in the plant of the Tabor Manufacturing Company of Philadelphia, where Mr. H. K. Hathaway, vice president of the company, took considerable time and pains to explain it thoroly. Scientific management has practically revolutionized the work of the establishment. Before its introduction there were more than 100 workmen at the machines and less than 6 men in the office; now there are 70 workmen in the shop and 30 men in the office and planning department and the output has been increased over 300%.

[2] From a paper read by Mr. Taylor before the American Society of Mechanical Engineers, June, 1903. Mr. Taylor is a former president of the society.

and such appliances as will enable him to accomplish his task with certainty.

Third. He should be sure of large pay when he accomplishes his task.

Fourth. When he fails he should be sure that sooner or later he will be the loser by it.

When an establishment has reached an advanced state of organization, in many cases a *fifth* element should be added, namely, the task should be made so difficult that it can only be accomplished by a first-class man.

Under the first principle, the difference between the Taylor plan and ordinary practice lies in the very careful study (by experts with stop watches) of each element in each task, so that definite information is available as to how long it should take. In ordinary practice, the fixing of piece-work rates is left to the judgment of the foreman or piece-work specialist, and the rates are often changed. Under Mr. Taylor's plan rates are inflexible unless conditions change.

In the application of the second principle, Mr. Taylor goes much further than is customary in standardizing tools and machine accessories, and systematizing the storing and distributing of materials, sharpening of tools, and the like. Two unique features are the planning department and functional foremanship, the latter calling for a corps of specialists, each with a single function, instead of the military type of organization, under which the foreman is responsible for the work and discipline of all the men under him and all the machines which they use. The planning department is designed to take out of the hands of foremen and men all the planning of work and how it is to be done. The workman is merely to act upon written instructions. To make sure that the work is properly performed, the supervision formerly divided between the superintendent and foremen is assigned to a number of persons: (1) the gang boss, who has charge of the preparation of all work up to the time it is set in the machine; (2) the speed boss, who sees that proper cutting tools are provided and machines properly operated; (3) the inspector, who is responsible for the quality of the work; (4) the repair boss, who sees that the workmen keep their machines clean and properly oiled; (5) the route clerk, who lays out the exact route by which each piece of work must travel from machine to machine; (6) the instruction card man, who has charge of making up written instructions for each job; (7) the time and cost clerk, who prepares accurate cost data; and (8) the shop disciplinarian, who handles all matters of discipline and adjustment of disputes.

The foregoing briefly describes what is meant by scientific management *in shops*. As a system, its details have been well developed and it is in successful operation in a number of important manufacturing establishments. For branches of railroad work outside the shops, however, no definite plan has been worked out, nor have any experiments been made to determine whether the principles or details of *shop* scientific management are superior to the best practice of well-managed roads in activities outside of the shops.

Mr. Brandeis, in his brief in the rate controversy, is not so definite. He describes scientific management as involving a careful analysis of each unit, and a comparison of each of the smallest steps in the process with an ideal of perfect conditions. The system means, he says, that before anything is done, it must be determined what shall be done, how it shall be done, and what it shall cost. Planning in advance, he explains, is the essence of the new system. It affords a stimulus to workmen in the form of a higher rate for greater output. It shifts the burdens of management from employee to the management, where they belong. It demands universal preparedness, full and complete records, and the ascertainment and application of the best attainable methods, practices, tools, and machines; and it means further that all tools, machines, and appliances shall be properly standardized and in perfect condition.

This summation is admirable so far as it goes, but it is incomplete. The features which fail to get mention are very important and probably are those upon which Mr. Taylor would place strong emphasis. Nothing is said about the long time required for patient and careful study in the introduction of the Taylor system, nor its delicacy of adjustment, calling for thoro and painstaking effort. There is no reference to the difficulty of finding exceptionally skilled experts to specialize in the new field of transportation. The number of such experts is exceedingly small. These omissions in setting forth the scope and plan of scientific management are of serious consequence, since the public is only too ready to believe in new treatments, and as a result a swarm of unqualified or imperfectly qualified "physicians" is already appearing. The railroads are continually importuned to adopt schemes or devices which their originators believe will bring large returns, but which are obviously impractical or are likely to be vitiated in experience by some fatal defect. After many experiments of this kind, the

railroads are naturally wary or skeptical. It is of the greatest importance, both for the railroads and the system of scientific management, that a clear distinction be made between the genuine thing and the poor copy. Amidst diversity and disagreement of doctors, railroad men, with large responsibilities, may well hesitate and insist upon proof before accepting the new doctrine.

To what sources may they turn for this proof? Unfortunately, a convincing demonstration, either affirmatively or negatively, is yet to be made in railroad operation. Only in textile mills, printing and binding concerns, and other manufacturing establishments, is there ample proof that scientific management is both practicable and profitable, that it has increased output and at the same time decreased cost. The testimony before the Interstate Commerce Commission is replete with concrete illustrations of substantially increased net returns, notably in the cases of the Yale & Towne Company, The Link Belt Company, Tabor Manufacturing Company, Brighton Mills, and Plimpton Press.

The only instance of the application of something similar to the Taylor system in railroad operation is the experiment made on the Atchison, Topeka & Santa Fe Railway in 1904–07 by Mr. Harrington Emerson, president of the Emerson Company of New York, who are standard practice and efficiency engineers. Mr. Emerson is the author of the inspiring book, *Efficiency*, and an earnest advocate of advanced methods of securing efficiency. He has had a wide experience in installing his system in industrial establishments and has devoted much time to developing a plan particularly adapted to railroad shops. The results, as described in articles by the editor of the *Engineering Magazine* and by Mr. Emerson himself in several articles and lectures, indicate on their face that the workings of the new system were remarkably successful. In selected items of expense and unusual units of cost, large savings are shown. In one minor item, the maintenance of belts, astonishing results were achieved by more scientific treatment from workman to purchasing agent.

It will be remembered that Mr. Emerson was the authority for the statement that the railroads, by the adoption of scientific management, could save a million dollars a day. While it is not clear from his testimony before the commission, Mr. Emerson has stated elsewhere how he arrived at his estimate of a million a day. He took the last statistical report of the Interstate Commerce Commission and applied to each grade or class of employee and

cost of materials the percentage of efficiency obtaining in railroad operation at this time, according to his observation and judgment. Thus he ascertained what it would have cost to run all the railroads at 100% efficiency. He believes, for instance, that shops are but 60% efficient; section forces, less than 50%; stationmen, 60% to 80%. Applying the same process and reasoning to the cost of materials, he estimates, for example, that fuel consumption is but 50% efficient. It requires an average saving of approximately 23% in *all* items of expense to reach a million per day. If the saving applied only to the accounts specifically referred to, namely, section forces, shops, fuel, and freight stations, it would be necessary to reduce each of these by 50%. In either case, the operating ratio must be cut down from 66% to 51%. The result would be also that 310,000 workmen out of a total of 1,500,000 would be dispensed with.

Since this one example of efficiency methods is held up to the railroads for emulation, it is advisable to call attention to certain conditions, not emphasized in the descriptions of accomplishments; not with any thought of minimizing the good that was accomplished while Mr. Emerson was with the Santa Fe, but to explain why the results of the experiment are not convincing.

In the first place, the new system was introduced in the Santa Fe shops just after the collapse of a lengthy strike of machinists. Shop forces were demoralized and maintenance costs abnormally high, because of the inevitable employment of incompetent men to take the place of the strikers. A return to normal conditions, under any system, would have shown a marked improvement when results were compared with the former abnormal period.

In the second place, the introduction of high-speed steel for tools for cutting and drilling was coincident with the installation of Mr. Emerson's system, although not one of its distinct or unique features. High-speed steel was in general use before that time in other railroad shops; in fact, railroads were among the first extensive users of Mr. Taylor's invention. It is certain that the Santa Fe would have adopted the new tool steel, as other roads had already done, even had Mr. Emerson's system not been adopted. Mr. Taylor's new steel revolutionized the art of cutting metals and very much reduced shop costs. A large part of the Santa Fe saving, therefore, was due as much to high-speed steel as to the new system of management.

In the third place, Mr. Emerson's usual method of expressing the expense of locomotive maintenance is in cost per "road unit."

This is an unusual and misleading average because it includes the weight of the locomotive as a factor and assumes that the repair cost varies directly with the weight. It assumes that an engine weighing one hundred tons will cost twice as much to repair as one weighing fifty tons. This assumption is not entirely incorrect; it is true that a heavy engine costs somewhat more to maintain than a light one. But the cost of repairs does not vary directly with weight. In this case, Mr. Emerson's unit gave a favorable showing to the new system, because of the purchase of a large number of new and heavy locomotives during the first two years under his régime. Naturally, the new engines did not call for the same measure of repair work as the older ones, which had kept up the cost in the previous period with which the comparison was made.

The unsatisfactory character of the ordinary accounting unit, "cost of repairs per locomotive mile," is recognized. Yet, with a knowledge of conditions, it is a better index than the Emerson unit, which assumes that cost varies directly with weight. The most reliable indication of cost of maintenance is afforded after all by the "per mile" and "per year" figures in the annual reports. In the figures tabulated below, comparison is made between the Santa Fe and the Union Pacific, running through similar territory to the north, and also the Southern Pacific, running through similar territory to the south. It will be noted that the Santa Fe costs have been steadily higher since 1903 than those of either of the Harriman lines. Taking the average of the seven-year period following the introduction of the new system on the Santa Fe (1904–10), its "per mile" costs are 20% higher than the Union Pacific and 14% higher than the Southern Pacific.

COST OF LOCOMOTIVE REPAIRS AND RENEWALS

Year	Per Mile			Per Locomotive		
	Santa Fe	*Union Pacific*	*Southern Pacific*	*Santa Fe*	*Union Pacific*	*Southern Pacific*
1903	9.97c.	10.39c.	8.62c.	$3,042	$3,590	$3,289
1904	13.42	11.23	10.33	3,772	3,565	3,588
1905	14.87	11.56	11.23	4,165	3,791	3,473
1906	11.08	8.61	11.26	3,101	3,068	3,531
1907	10.50	8.66	10.48	3,037	2,933	3.563
1908	13.74	10.70	10.79	3,714	2,108	3,234
1909	11.95	11.50	11.85	3,133	3,149	3,182
1910	12.87	11.72	11.63	3,832	3,656	3,551

In his testimony before the Interstate Commerce Commission Mr. Emerson referred to the time taken to give a locomotive shop repairs. By his system the time was reduced from sixty to thirty days. To the uninformed public this would seem a gratifying accomplishment. But even thirty days is too long. Many of the railroads do better. On the Chicago & North Western, for instance, the average is fifteen days. In this case again the improvement is relative only. The final results are no better than the average of other roads, nor as good as those of roads which are very well managed.

Since the Santa Fe experiment lacks convincing proof, the railroad manager must turn to the records of the manufacturing establishments where scientific management is known to be eminently successful. The impulse of the railroad man, as well as of the manufacturer, is to acknowledge the benefits of the system elsewhere, but to doubt that it can be successfully applied to the complex details and difficulties of *his* business with which the efficiency experts cannot be intimately acquainted. His first answer usually is, "This may work elsewhere, but not in my plant." But open-minded railroad men, while admitting that they may be giving a stereotyped objection, and that in the course of years some roads may find features of value in the system of management thus rudely brought to their attention, may nevertheless urge with good reason that especial difficulties stand in the way. The success of scientific management in commercial undertakings does not in itself prove that the new system would be equally effective in railroad work. The essential differences between railroads and manufacturing establishments must be borne in mind. These difficulties may be summarized under four headings: (1) area and extent of activity; (2) nature of product or output; (3) relations with the public and the government; (4) relations with labor unions.

(1) The differences in area and extent of activity are obvious: the manufacturing establishment with its concentrated forces and intensive activity; the railroad with its long lines of communication, scattered units of organization, and extensive range of action. Railroad forces, spread out thinly over the line, necessarily work under scant supervision. Section forces, stationmen, signal and repair men, car inspectors and oilers, work-train and way-freight crews, and many other employees located in small groups at intervals of two or three miles, must be left largely to them-

selves, and their work checked chiefly by inspection. It is obviously impracticable to afford the constant supervision which is such a vital part of the new system. In a manufacturing plant thousands of men may work in one group of buildings, subject to the supervision not only of gang bosses and foremen, but also of all officers and owners of the establishment. In contrast, compare the one item of section forces. Gangs of six to ten men are scattered over every section of three to ten miles, the average being one man per track mile. This attenuated line of two or three thousand laborers on a double-track road, say, from Boston to Chicago, a distance of more than a thousand miles, could be concentrated on one acre in a textile mill.

(2) With respect to the nature of product or output, there are also distinct differences between an industrial establishment (such as the Tabor Manufacturing Company), with a uniform output, and a railroad repair shop, where there is little uniformity in the work. The cost of the work in a railroad shop is a small part of total operating expenses.[1] Shop and repair work is *incidental* to the main function of producing transportation. The value or efficiency of railroad shop work depends upon how well it assists in the safe and expeditious movement of passengers and freight. It cannot be systematized to the same degree as in manufacturing shops, where the character of the work varies but slightly. Oftentimes, too, it is much more important that railroad repair work be done quickly than at the lowest possible cost. This feature applies particularly to repairs made at the engine houses and outlying car inspection points.

In railroad shops which carry on the manufacture (as well as the repair) of locomotives and cars, it would be practicable to adopt a large part of Mr. Taylor's system. But such shops are relatively few in number. The great majority of the railroads find it cheaper to purchase their rolling stock, because the best use of the railroad shops and the mechanical department organization is to maintain, not to manufacture. It has been found that they cannot compete on even terms with an industrial concern, which specializes in manufacture.

(3) Quite apparent, also, are the dissimilarities between railroads and private concerns in their relations to the public and governmental regulating bodies. A railroad is a public service

[1] The cost of maintaining locomotives and cars averages about 18% of operating expenses.

corporation. The public rightfully demands that adequacy of service shall outrank the payment of dividends. A manufacturing establishment exists solely for profits. If it ceases to be profitable, it may close its doors or change the nature of its business. The operation of an unprofitable road must continue. It has two functions, public service and profit making; it may not neglect service to favor profits. Necessarily, therefore, methods are employed in the interest of public service even tho they involve economic loss, and would not be resorted to if railroads were operated as private industries.

For example, paralleling lines, trolley competition, or other changed conditions may make certain divisions, branches, or trains unprofitable; yet satisfactory service must be continued, with little thought of returns. The losses from such divisions, branches, or trains are perforce absorbed in the earnings of the trains which are better patronized. Again, the demand for prompt and regular movement of freight often results in cars being moved with a light load. If they were held for a full load, the regularity of the service would suffer. As a result only one-third of the capacity of freight cars is utilized. In other ways economies in railroad operation could be brought about at the expense of the service, but these are desired neither by the railroads nor the shippers.

The effect of governmental regulation is much more apparent in railroad operation than in private industries, and, while both proper and desirable, it adds to the cost of operation. Mr. Howard Elliott, president of the Northern Pacific Railway, recently stated that the cost to the railroads of the United States for board and commission control amounts to $85 per mile of road per annum, an aggregate of $20,000,000. This regulation affects nearly every detail of operation. Tho justified by public policy, and apparently necessary to keep *all* the railroads up to a standard which the well managed might adopt without governmental requirement, it has an important bearing on any comparison which may be made between railroads and manufacturing establishments not so circumscribed.

For the safety of trains, again, every precaution must be taken to avoid accident. Methods which might reduce costs but which would also add to the element of risk are necessarily barred. For that reason certain classes of work are performed under day rates rather than by piece work. It is more important to have the task

well done than to make a slight saving in cost. One accident as the result of such apparent economy would offset the savings of a long time.

(4) Perhaps the greatest barrier to the introduction of any system designed to accomplish savings which will diminish the number of employees is the labor organization. Practically every branch of the railroad service is strongly organized and militant. The manufacturer has his labor problem also; but he can close down his plant or lock out his men if he sees fit. With railroads, resistance to demands considered by them as unreasonable must not be allowed unduly to affect service. Trains must be kept moving at any cost, and if men cannot be had to take the place of striking employees, or if, before a strike is declared, it is plain that resistance is useless, the company must make the best terms it can, and maintain peace.

Any system or contrivance which has for its object the creation of competition among workmen, or which will cause them to exert themselves, is repugnant in principle to labor leaders. Its direct result, as they see it, is to "speed up," and to lessen the number of workmen. Their attitude is indicated by the strong opposition of the Brotherhood of Locomotive Engineers to the introduction of the Mallet compound locomotive. This type of machine is capable of handling very much heavier trains, but calls for no more effort and very little additional skill on the part of the engineman. The organization held out strongly for double pay, on the theory that the Mallet engine does twice the work of an ordinary engine and, if ordinary engines were used instead, double the number of enginemen would be necessary. The issue came near precipitating a strike on all the western lines last fall, but was finally settled by mediation under the Erdman Act, the enginemen receiving a bonus of $1 per day over the highest existing rate, instead of double pay as demanded. This settlement, however, will hardly be permanent. Opposition will probably continue and the question will undoubtedly cause friction in future negotiations between the railroads and their enginemen.

Of similar significance are the organized efforts of conductors and trainmen to prohibit double-heading. By this is meant the practice of running two engines on a freight train so as to increase its length. The resulting decrease in the number of trains and the consequent smaller number of train crews are opposed by the men.

The year 1910 saw the successful culmination of an ambitious

plan to "standardize" the wages of conductors, trainmen, and yardmen in the eastern states, that is, to set a uniform rate per day, per hour, or per mile for each class of service, regardless of local conditions.[1] The road with the highest wage scale (the Baltimore & Ohio) was selected as the battle ground, and the entire forces of the train-service brotherhoods focussed upon it in a demand for new and unreasonably high rates. To prevent a strike, the railroad invoked the aid of the Board of Mediation (under the Erdman Act), and the award, while not granting the rates demanded, carried with it substantial increases over rates already considerably higher than those of other roads in the East with distinctly different operating characteristics. The new basis was then in turn forced upon practically every road in eastern territory. The increases in New England averaged between 20% and 30% and in some cases exceeded 50%. At the same time long-standing differentials between different grades of employees were seriously disturbed. Throughout, the new wage basis and working rules (prescribed partly by governmental mediation) are far from scientific or equitable.

At this writing (April, 1911) the boiler makers of the New York Central lines have been on strike for ten weeks because of the introduction of piece-work rates at Collinwood, Ohio, on the Lake Shore Railway. Undoubtedly, former abuses of the piece-work basis have much to do with the determined opposition to its introduction in this case. Yet the same opposition would probably have occurred if it had been the Emerson bonus plan used on the Santa Fe. In fact, the head of the strongest organization in railroad service is reported as having said that the bonus system and his organization could not exist together on any railroad.[2]

These difficulties, serious as they are, may be met by experts. But the railroad man sees no definite plan for the application of the new "principles"; and he has a fondness for the concrete. After studying scientific management as applied to shops he realizes that when similar efforts are made to extend it to the whole line of railroad operation, long and expert study will be needed, and new and unsuspected modifications of the system must be made to meet the exacting conditions of railroading.

[1] See a paper by the present writer on "Standardizing the Wages of Railroad Trainmen," *Quarterly Journal of Economics*, November, 1910.

[2] Warren S. Stone before the National Civic Federation, January 12, 1911.

The technical record of railroads in the United States is creditable. They have had to meet exceptional difficulties. In their effort to keep pace with the commercial development of the country, a policy of expediency has in many cases justified standards of construction, maintenance, and operation which would have been considered faulty in an older country, like England, whose railroads came after, not before her industrial growth and dense population. But in the past two or three decades many deficiencies have been corrected and the work of eliminating other imperfections is progressing.

In the interest of a clearer understanding of the situation by the public, it would have been worth while for the railroads to offer more of constructive evidence to show that altho scientific management, as a system, has not been adopted by them, yet the principles of sound business management have free play in a large number of shops and other railroad operating activities. So far from being ignorant as to costs, many roads have statistical departments which compile and disseminate information upon every detail of operation, so that each unit of efficiency may be compared with other units, or with the same unit of another division, another railroad, or another period. Instead of being out of date in shop equipment, or behind the time in shop practice, they are, on the average, in advance of manufacturing establishments. They might have shown further that railroads, while far from perfect, are constantly improving in efficiency; that railroad officers, both of the so-called "practical" school and those who are graduates of colleges and technical schools, are earnest in their effort and have ample incentive to operate economically. Railroads believe in and practise the free and frequent exchange of ideas by associations and clubs which include every branch of the service. In fact, they are unique in having so few secrets concerning operating methods, and in their willingness to tell of, hear about, and profit by their mutual experiences.

As an illustration of the work of one association, witness the monthly reports of the Car Efficiency Committee of the American Railway Association. The statistical exhibit, showing every detail of operation and revenue connected with freight movement on every railroad in the country, is a convincing example of the scientific thoroness with which such information is compiled and distributed for mutual benefit. Every department has its association doing similarly scientific work. As other instances, take

the Railway Engineering Association and its careful studies and experiments in perfecting rail design and cross-tie preservation; the Master Car Builders' Association and its exhaustive tests of air-brake apparatus; the Master Mechanics' Association and its painstaking efforts to evolve a perfect super-heater and mechanical stoker; and the Railway Signal Association and its thorogoing work of standardizing the art of signaling.

There may be ground for the impression that railroads are in a class by themselves in an attitude of self-sufficiency, that is, a belief that they can learn little from the experience or ideas of those outside the railroad circle. Yet that this is not altogether true, and that the railroads not only welcome but seek assistance from outside experts, is shown by the establishment of the Bureau of Explosives. This bureau was organized under the auspices of the American Railway Association about five years ago by Colonel Dunn of the ordnance department of the United States army, working closely in conjunction with the late Dr. Dudley (then chief chemist of the Pennsylvania Railroad) and a committee of other railroad officers from different sections of the country. The American Railway Association realized that they did not have a man within their ranks with the same wide knowledge of the characteristics of explosives and the best manner of handling them, and were glad to secure Colonel Dunn's valuable services. He has accomplished much in organizing a system and formulating rules of inspection which have reduced to a very large extent the accidents formerly frequent in the transportation of this dangerous class of freight.

In the committee work of the Railway Engineering Association, Master Car Builders, Master Mechanics, Signal Engineers, and other railroad technical associations, the coöperation and active assistance of outside experts is sought. There are eleven university professors on the various committees of the Railway Engineering Association. In the active work of the railroad mechanical associations there are as many more. . . .

The railroad man, knowing how keen is the anxiety of his profession for improvement and vigilance, has been and is proud of the achievements of American railroads. He believes that railroad efficiency is higher than the average in manufacturing establishments, and can hold its own with any line of enterprise in the United States. He thinks, too, that in the recent rate hearings the railroads should have been measured not with the exceptional

industrial establishment, but with the average. He recognizes, none better than he, the existing deficiencies in railroad management; but that they are greater or more flagrant than those in other large undertakings he will not admit. The extended area of railroad activity and the problem of adequate supervision make it difficult to secure high efficiency and use of materials. The tendency of labor union policy is increasingly to trammel the manager. He is also hampered by the difficulty of securing competent men in supervisory positions. Expert knowledge is not required to point out losses and inefficiencies. They are apparent. But criticism should be accompanied by practical remedial suggestions.

The history of American railways shows that their progress has been steady and substantial. A comparison of any two periods ten years apart will reveal impressive increases in efficiency. The net train load, for example, has increased nearly fifty per cent in the last ten years. Such advances in nearly every case have been the result of development and improvement of existing methods and facilities. The new and improved have been the adaptations of the old. And judging by this steady improvement in the past, it may be expected to continue in the future.

The solution of the problem of how to effect further economies and yet maintain good service seems to lie in a more rigid application of the railroad's own kind of scientific management and a continuation and enlargement of the best practices of the best railroads, so that the operating results of the least economical may approach those whose efficiency is marked, and these in turn set new and higher standards. *A new system is not needed so much as a more determined, and a more general application of the sound and business-like methods which have already been found effective in railroad work.*

After all, there is little essential difference between the aims and accomplishments of scientific management as advocated by the new experts and scientific management as practised by the exceptionally well-managed railroads. As a system, it means a careful study and analysis of each element of operation, and the application of the methods best adapted to bring about the best results under the given conditions. Many railroads are doing this successfully; others are doing it in part. In the nature of things, however, their efforts have been directed more to the

"high spots" or to those features of operation which are most in need of correction or which promise the largest or quickest returns. Scientific management, as a system, takes a broader view and requires that the same careful study and treatment be given to every detail of operation as is given, say, to the subject of train loading. Obviously, there is a point where this would be unprofitable,—where the cost of the system would exceed the saving.

The real difference, then, between the efficiency experts and the railroads in their conception of scientific management is not in kind but in degree. To find a common ground means mutual concessions. On the part of the efficiency expert it will require less stress upon "system," "principles," "dependent sequences"; it will require more knowledge of the practical problems of railroads, more respect for what the railroads have accomplished, and less exaggeration and generalization concerning waste and possible savings. On the part of the railroad a more receptive attitude is needed for suggestions from the outside and a recognition of the fact that, notwithstanding commendable progress in operating economies, much yet remains to be accomplished.

Among the important features of Mr. Taylor's system of shop management, the principle of time study might well become a part of the practice of any railroad shop with a piece-work basis. The piece-work schedules of today are generally an evolution from "cut and try" methods. Their defects are recognized. Mr. Taylor's second principle, of standardized conditions, is equally important, and many railroad shops come reasonably close to standard practice.

But apart from shop operation, other and greater avenues of economy are being earnestly studied. The delays and red-tape obstruction to local initiative,[1] will yield to some plan of decentralizing authority, such as is now being tried on the Harriman lines. There are undoubted economies in further standardizing of equipment and materials, as well as in improved methods of storing and distributing supplies. There is promise of economy in the experiments now being made by the American Railway Association in clearing-house accounting for joint use of cars. A sub-

[1] Mentioned by W. M. Acworth, the English economist, as a defect in American railroad organization. In the same statement, made on the eve of his departure February 1st last, he expressed surprise that the newspapers should give so much space to criticism of railroad efficiency. In his opinion American railroads are the most efficient in the world. He believes that the skeletons in the railroad cupboards have all been buried and that now the roads "would do well to open their cupboards and let the public see how sweet and clean they are."

stantial saving in fuel may be made by a more general adoption of the methods of the roads having the best fuel records. And throughout the service there is crying need for more and better supervision.

Better supervision calls for better men, and to that end the educational activities of the railroads should have wider scope and more effective organization.[1] A system of management is not needed so much as managers. The system is not as important as the man. A good system will not altogether save a poor manager, nor will an imperfect system altogether hold back one who is ambitious and able. Mr. Taylor himself recognizes this in his statement, "the first object of any good system must be that of developing first class men."

Except in the important particulars of time study and functional foremanship, the system advocated by the experts and the system practiced by the railroads are not very far apart. Both have for their object that which is desired by the railroads and the public,—ability to give good, safe, and economical service. And if achieved either by an improvement of present methods, or by an adaptation of the new system, private management of railways will have strengthened its claim to continuance.

[1] J. Shirley Eaton, in *Education for Efficiency in Railroad Service* (1909), says: "In the course of railroad development, there was a first era, which was the era of railroad building. Any railroad was better than a wagon road. There was next an era of coördination of the railroad service and finance to the commercial and financial conditions as a whole with which the railroads were called upon to deal. This was the time of the traffic organization and railroad consolidation. Next came the era of internal adjustment on the physical and mechanical side—perfection of machinery, cutting down grades, strengthening bridges, increasing the train unit. And now has come the sociological adjustment. The human part of the machine is quite as vital as the steel and wooden part in producing efficiency, and so in increasing the income."

PART IV

RAILROAD FINANCE

CHAPTER XVIII

ANALYSIS OF RAILROAD REPORTS [1]

The bonds and shares of the railways of the United States form the most available investments or instruments of speculation for the people. The general knowledge about railways is greater and the industry itself more firmly established than is the case with other large enterprises. The securities of these railways are the ones most prominently dealt in upon our exchanges, thus giving to holders the important advantages of easy and quick purchases or sales. For these reasons it is advisable that the items which are contained in the usual annual reports should be analyzed at length and in detail, in order that any purchaser or holder may be able to form for himself a general idea of the meaning of railway statistics and of the importance of the differences appearing in those reports from year to year.

The Great Eastern Railway is a suppositious road in the United States east of the Missouri River. Having no actual existence, its supposed records can, without invidious comparisons, be made the text of an examination into the meaning of railway statistics, and the relation of one item to another in such tables as are usually printed in railway annual reports.

Although paying four per cent. dividends, it is assumed that the stock of the Great Eastern Railway is not quoted at very high prices on the exchanges. A company which is really earning four per cent., and which seems likely to continue earning and paying that dividend, usually finds its stock well thought of in financial circles. Contrary to this rule, a holder of Great Eastern shares sees his stock declining under daily sales presumably by "insiders." Naturally his attention is aroused; he asks himself why the prices of his shares should fall; in search of information which should

[1] From Thomas L. Greene, *Corporation Finance*, chapter VI (1897). Reproduced by permission of the author and G. P. Putnam's Sons. The reader should note that the book from which this chapter is taken was published in 1897. Since that date prices have advanced markedly, and other important changes have occurred. Therefore statements of fact that were correct in 1897 may not be correct at the present day. The selection is included none the less, because of the critical analysis of railroad reports that it contains. On railroad reports and accounts, see Vanderblue and Burgess, pp. 398–409, and Jones, pp. 220–221, 239–240.—Ed.

satisfy his questionings, he first takes up the annual report of his railway and looks over the figures given therein. On the first pages he finds an income account for the last fiscal year, containing nothing which on the face of it could be construed unfavorably. The statement of the result of the year is as follows:

GREAT EASTERN RAILWAY: INCOME ACCOUNT

TO JUNE 30

Gross earnings: passenger		$1,080 000
freight		5,600 000
mail and express		120 000
Total		6,800 000
Operating expenses (62 per cent.)		4,200 000
Net earnings		2,600 000
Add interest on bonds owned		250 000
Gross income		2,850 000
Fixed charges: taxes	$100 000	
bond interest	1,300 000	1,400 000
Net income		1,450 000
Dividends at four per cent		1,200 000
Surplus for the year, carried to profit and loss		250 000

On succeeding pages of the annual report are given the results for the year of the Rich Valley Railroad, a branch or feeding line, owned by the Great Eastern Company, but operated independently:

Gross earnings	$1,500 000
Operating expenses	1,400 000
Net earnings	100 000
Guaranteed bond interest paid	700 000
Deficit for the year	600 000

There is nothing which necessarily shows bad management in the fact that a "feeder" is not self-supporting. The Rich Valley, as its name implies, may be a short line running through a rich agricultural and manufacturing district, the greater part of whose traffic is carried by the parent road to the great markets. Were it not for this branch the traffic would seek a rival road. Hence in this case profits resulting from the carriage of this extra business are worth to the Great Eastern Railway, it is assumed, a great deal more than the $600,000 which it loses through its guaranty of Rich Valley bonds. The policy of building or purchasing branch

lines which are run at a loss may, of course, be carried to such an extreme as to involve the guaranteeing company; particularly when the real effect of such annual losses is concealed by the method of book-keeping adopted in this case. Clearly the Great Eastern Company must pay this deficit of $600,000; but from what fund? Since the gross and net earnings of the main line receive all the benefit of the traffic turned over to it by the branch, and since, as we have assumed, this benefit is great, it follows that the cost of procuring that extra traffic is a proper charge against the income helped thereby. In other words, the annual loss of $600,000 on the branch line, unless clearly but a temporary deficit, ought to be deducted from the gross income of the Great Eastern Railway before a dividend is declared. If this is not done—and a glance back at the income account presented shows no mention of the item,—the real earning power of the company is to that extent overstated and the dividend unjustifiable.

How, then, is the deficit of the Rich Valley branch carried? To answer this question the general balance-sheets for two years must be examined. These general balances show on the one side the assets of the company and on the other the liabilities. The different amounts are stated at their face and not at their intrinsic values. Ordinarily it is useless labor to go through a company's general balances for the sake of getting at the actual worth of the properties. Hence, for the information of ordinary shareholders, the most important object in having general balance accounts is the opportunity afforded for annual comparison. If we note the changes in the items from one year to another, we can often get valuable hints about the real prosperity of the company, because the facts thus revealed may not be mentioned in the text of the annual report. First, then, should be stated the balance-sheet for two years:

GREAT EASTERN RAILWAY

GENERAL BALANCE-SHEET, JUNE 30, PREVIOUS YEAR

Assets		*Liabilities*	
Cost of road	$45,000 000	Capital stock	$30,000 000
Cost of equipment	10,000 000	Funded debt (5%)	25,000 000
Stocks owned Rich Valley Co.	1,000 000	Interest accrued	500 000
Five per cent. bonds of Rich Valley branch owned	5,000 000	Due connecting roads	600 000
Advances to Rich Valley	400 000	Due for wages	500 000
Due from connecting roads	250 000	Supply accounts payable	100 000
Materials on hand	200 000	Claim vouchers audited	100 000
Accounts receivable	100 000	Profit and loss	5,500 000
Suspense accounts	100 000		
Cash on hand	250 000		
	$62,300 000		$62,300 000

GREAT EASTERN RAILWAY

GENERAL BALANCE-SHEET JUNE 30, PRESENT FISCAL YEAR

(Corresponding to the income account given above.)

Cost of road	$48,000 000	Capital stock	$30,000 000
Cost of equipment	11,000 000	Funded debt (5%)	27,000 000
Stocks owned, Rich Valley branch	5,000 000	Interest accrued	700 000
Advances to Rich Valley	1,000 000	Due connecting roads	1,000 000
Due from connecting roads	200 000	Due for wages	700 000
Materials on hand	150 000	Accounts payable	300 000
Accounts receivable	300 000	Bills payable	1,000 000
Suspense accounts	200 000	Supply accounts payable	300 000
Cash and cash items	100 000	Claim vouchers audited	200 000
		Profit and loss	5,750 000
	$66,950 000		$66,950 000

A brief explanation of the items first may be desirable. The costs of road and equipment are approximate statements of the amount of money spent for these objects, though they contain items which are only indirectly a charge against cost. For example, in those balance-sheets will be noticed an increase of bonds from $25,000,000 to $27,000,000 during the year. If these bonds were sold at a discount, say twenty per cent.; the amount so deducted from their face value, $400,000, would not represent money put into the road directly or physically, though the whole increase, $2,000,000, it will be noticed, is added to cost of road in another

way, *i. e.*, in its lack of credit. Sometimes this item of bond discount does not arise from lack of credit but from an attempt to issue bonds at a rate of interest so low, compared with the ruling rate in the money market, that par cannot be obtained for the bonds. In such cases, since the income account presumably is benefited by the small annual interest charges, that same income account should be debited each year with a proportion of the loss by the discount. The item profit and loss has misled many. If the assets foot up more than the liabilities (and every road tries to have it so, even as a matter of book-keeping, for appearance's sake), the item appears on the liability of the account. It will thus be seen to be what it really is, merely the balance between the assets and liabilities in the general balance-sheet representing the supposed excess of property over the capitalization and debts. It is not money in hand: it usually covers former annual surpluses which may long ago have been spent for equipment or on road, or invested in the materials carried in the storehouses and not yet put into the property. If a road has cash or salable securities in unusual measure, these will be found on the opposite side of the accounts as assets.

Another item is the interest accrued but not due. Such accrued interest should always be put down as a liability in balance-sheets, otherwise an unreal prosperity would be shown at one time or an unreal depression at another, according as the bond interest becomes payable. In all railway tables there are found items of current accounts with connecting roads both debit and credit, cost of materials and supplies purchased but not yet used or charged to the respective operating departments, and the like, being things for which working capital must be provided. Two further items in our statements merit notice. Supply bills payable is one. Every report should be examined to see whether this liability is included. It is the custom for all large companies to buy their fuel, rails, ties, etc., on time. Hence every company on any particular date has a large amount of obligations out, which are not yet due and for which no notes have been issued. Technically these may not be considered in the balance-sheets until due, but since they are sure to become due shortly, there can be no true statement of the company's condition made without including them. Sometimes when engines and cars have just been purchased, these unrecorded obligations may be very heavy. Again, when in straits for money, railway companies do not hesitate to

pigeon-hole the bills for supplies sent them until the accumulated debts become large; and, if not stated in the balance-sheets, an untrue appearance of ease in money matters is given.

Audited vouchers often form a growing obligation when traffic is depressed. Claims for losses of goods and rebates (not always unfair) are common; in spite of care, overcharges in the freight bills rendered consignees will be made through the errors of clerks; wrecks may destroy much property for which the company is responsible; cattle may be hurt by trains; and, worst of all, accidents may kill or maim passengers. The claims thus presented to the company are often very large in amount. After investigation a certain portion are pronounced true claims and marked for payment. Such items are called "audited claims or vouchers" and should find a place in every balance-sheet. The still larger amounts of claims for losses, overcharges, or rebates not yet passed upon cannot well be stated in the balance-sheet, because their amount is uncertain, yet when "cut rates" are freely given the aggregate of claims and rebates which must presumably one day be paid may be so great that the amount, if known, would make a serious impression. Yet, on the other hand, where the sum of such unaudited claims stays approximately the same from year to year, no real harm is done by not attempting to include them in the company's tables.

Among the assets the items "accounts receivable" and "suspense accounts" require little explanation. These are claims carried by the company against other roads or against merchants. They may be good or they may not. Every company should have a separate table of "Profit and Loss," to which all such doubtful credits should be charged. It may be technically correct bookkeeping to keep uncollectible accounts standing among the assets of the general balance-sheet, but no matter how the rules of bookkeeping treatises may read, the object of all corporation accounting is to represent the commercial facts.

Companies which hesitate to deduct losses (branch-line losses included) from their income account and yet shrink from actually calling such losses "assets" should charge such deferred claims to "Profit and Loss," crediting that account with the annual surpluses from operation. The difference would then show the real earnings. If at any time such old claims should become collectible, the same account could be credited with the sums thus recovered.

The array of figures in our general balance-sheets looks a little

bewildering; so to make the matter clearer, we will tabulate the changes during the year:

EXPENDITURES:

FOR WHAT PURPOSE INCURRED

Increase in cost of road	$3,000 000
" " cost of equipment	1,000 000
" " advances to Rich Valley	600 000
" " accounts receivable	200 000
" " suspense accounts	100 000
	$4,900 000

RESOURCES:

WHENCE DERIVED

Decrease in amounts due from connecting roads	50 000
" " material on hand	50 000
" " cash and cash items	150 000
Increase in funded debt	2,000 000
" " interest due	200 000
" " amounts due connecting roads	400 000
" " wages due	200 000
" " unadjusted accounts	300 000
" " bills payable	1,000 000
" " supply accounts due	200 000
" " vouchers audited	100 000
" " profit and loss	250 000
	$4,900 000

This summary of changes in the position of the company during the year is worth study. The words "expenditures" and "resources" are used in their book-keeping sense: a decrease in the amount due *from* other roads and an increase in the amount due *to* other roads being both alike resources for our present purpose. The statement shows an increase in investment in road and equipment amounting to $4 000,000, of which more hereafter. The deficit of the Rich Valley branch is seen to have been carried in the accounts also as an increase in value of plant, offset on the other side of the account by money newly borrowed. We are assuming that this is not a correct principle and that the value of the property has not been advanced a penny through the Rich Valley, since all the profit for the branch for the year has already been included in Great Eastern earnings. This system of disposing of branch-line losses in the accounts is resorted to mainly to allow of borrowing money to meet the deficiency. Carrying subsidiary losses as assets and borrowing money or issuing bonds therefor, has been a common practice. The combination of many small roads into a large system permits such accounting, either through mistakes,

optimism, or for purposes of deception, without danger of detection by superficial examination. Sometimes this way of concealing deficits is practised for a year or two during hard times, the officers intending to apply the surplus revenues of succeeding prosperous years toward wiping out all these imaginary assets and the debts contracted to pay for them. Such a policy should be leniently judged, if honestly held. Of course it is also proper to treat in this way a genuine loan when repayment is reasonably certain. The balance-sheets further show that the only bonds owned by the Great Eastern Railway are those of the Rich Valley branch. A glance at the income account shows $250,000 received from this source. It thus appears that in order to show that dividends had been earned, the directors of the Great Eastern Company did not charge up the losses of the Rich Valley branch as they should have done, but did take credit to themselves for $250,000 unearned interest on their own guaranteed bonds.

We now begin to grow suspicious and scrutinize the items more closely. The bonded debt and the bills payable amount to $28,000,000, for which interest at but five per cent. on the total (and money is not always borrowed "in the street" at as low a rate as that) would amount to $1,400,000 per year, whereas but $1,300,000 is allowed in the income account. This may be an accurate statement for that particular table, since the bonds may not have been issued for the whole year and hence a year's interest may not yet be due; still our comparison shows that at least $100,000 must be added in our calculations to the requirements for another year.

The expenditures in the table show $3,000,000 spent upon the property and $1,000,000 upon equipment during the year; the other items make up a total expenditure of $4,900,000. Let us now see how this sum was obtained. Allowing for the discount, $2,000,000 was raised from the sale of bonds and $1,000,000 was borrowed on call (*i. e.*, can be demanded by the lender at any time), or for a definite (though short) period. The remaining $1,900,000 was gathered by piecemeal. Debts due the company were more closely collected, and on debts due by the company, it will be seen, payments were deferred. Wages are running farther in arrears and $200,000 more of bond interest was not paid. There is a new item "unadjusted accounts," which in this table undoubtedly is simply another name for more floating debt. Money due for supplies and for acknowledged claims has been held back. There has been further economy in the already too small stock of materials on

hand. Cash is dwindling; let the reader note the significant change in the wording of this item. A year ago it was "cash," now it is "cash and cash items." While "cash" has a definite meaning in Wall Street, the phrase "cash items" may cover a lot of rubbish which cannot be turned into cash at all—notes of bankrupts, disputed balances, and the like. It is not a harsh judgment which in this case assumes the amount of actual money on hand to be very small. Then the two offsets, accounts receivable and suspense accounts, down in the table as an increase of assets to the amount of $300,000, may fairly be rejected as assets altogether. A company in the position of the Great Eastern would not allow such accounts to be so much increased; for being in stress for money it presumably would have collected them if they had been good.

The table of changes certainly wears a very unfavorable aspect; yet one purpose of the managers has been accomplished, to cover up among a number of items a part of the money they have spent. Reliance is put on the fact that stockholders will not figure through the accounts.

Now as to the $4,000,000 increase in cost of road and equipment. Every report should contain a table giving in detail the items charged to construction or capital account. There is such a field for deception or for equally ruinous bad judgment in construction statistics that the utmost publicity should be insisted upon. The following construction account is divided (arbitrarily as to these figures) into columns of proper and improper charges to capital.

CONSTRUCTION ACCOUNT

	CHARGED TO CAPITAL	
	Properly.	*Improperly*
Road, for new rails	$400 000	
for damages from wrecks by accidents		$350 000
for renewals of ties		150 000
for double track	700 000	
for new bridges	100 000	
for real estate bought	750 000	
for new stations	150 000	
Total charged to road, $3,000 000.		
Equipment, for 15 replaced engines		150 000
for 15 new engines	150 000	
for 500 replaced freight cars		250 000
for 500 new freight	250 000	
for 25 replaced passenger coaches		100 000
for 25 new passenger coaches	100 000	
Total equipment, $1,000 000.		
	$2,600 000	$1,000 000

Every active concern must in some shape keep a depreciation account, to which shall be charged certain sums for renewal of machinery, etc., before profits are divided. If this is not done, the company will at the end find itself without plant and without money. In railway matters this is best accomplished simply by replacing cars and locomotives as they become worn out, and charging directly to operating expenses the cost of such new cars as do not add to the number of cars in use. In this way the quantity and quality of equipment or buildings or track are kept up at the expense of the annual earnings. In the construction account just given, $1,000,000 is improperly charged to capital and paid for by bonds, because the items cover depreciation and should have been included in the operating expenses. The test to be applied for the ascertainment of wrong charges to capital on equipment account is that of comparison. Every railway report gives, or should give, a list of the number of engines, passenger and freight cars in service at the close of the fiscal year. It is an easy matter to calculate the increases from year to year. For the reason that variations may at times occur, it is better to take a period of years. If the increases in the lists for, say, five years, multiplied by a fair valuation for each class, equal approximately the sums of the amounts charged to capital for new equipment during that period, then no wrong charges on this account have been made. In the case before us, we will compare the lists on two successive years.

STATEMENT OF EQUIPMENT

	Preceding year.	*Present year.*	*Increase*
No. of locomotives	185	200	15
" " passenger cars	375	400	25
" " freight cars	29,500	30,000	500

This statement of equipment explains why, in the table of construction just given, $500,000 charged for replaced engines and cars is marked as improperly debited to that account. The actual increase in the list during the year is but half that carried in the company's balance-sheet as cost of plant. Other items included in the construction table as improperly charged, are payments for train accidents and for replaced ties. These, of course, should go into operating expenses. Payments for wrecks may, however, be concealed under "double-track" or similar items if a company is determined to deceive. As to ties, it is fair to assume that these

last about seven years, depending, of course, on the climate and the kind of wood used. If we estimate 2800 ties to the mile of single track as about the average requirement, we have as an estimate of yearly renewals 400 ties per mile. Here, again, a number of years should be taken to obtain a fair average; but, in the long run, if a road's renewals of ties fall on the average much below 400 ties per mile per year, inquiry should be made as to the reason.

As to rails: the life of a steel rail is not yet definitely ascertained; perhaps twenty or twenty-five years may be taken in order not to be unfair to the company under examination. Estimating the weight of steel rails at seventy pounds per yard, the required weight per mile of single track is one hundred and ten tons. This would assume an average renewal of five or six tons per mile per year. A calculation spread over a number of years would show how far short of such an average a particular company had fallen. If its rails are new, or nearly so, such a calculation would be of value only as approximating the amount which will be required for that purpose in the future.

By our analysis of the Great Eastern's construction account we have ascertained the amount which should have been charged to operating expenses, to have been $1,000,000. This added to the $600,000 loss on the branch line, makes $1,600,000 which should have been deducted from income. As the sum applicable to dividends in the income account was $1,500,000, we reach the conclusion that the dividend was not really earned and should not have been declared.

It will be remembered that the road was operated for sixty-two per cent. The percentage of expenses to earnings is of little use except as a guide for further examination. Of itself it is only the percentage relation between two sets of independent figures. If a railway earns one dollar and spends fifty cents, it is operated for fifty per cent.; but if from any cause—water competition, let us say—it can get but seventy-five cents for the same unit of service, and if its expenses per unit stay at fifty cents, then it is operated for $66^2/_3$ per cent. Usually the volume of units of traffic increases as the charge per unit falls, so that the road makes as much gross profit from the larger as from the smaller receipts per unit; but manifestly we must go into details of the operating expenses if we would form a judgment upon the management. Here are four statistical tables of the Great Eastern Railway:

OPERATING EXPENSES

Maintenance of way and structures		$ 420 000
Maintenance of equipment:		
Passenger cars	$100 000	
Freight cars	300 000	
Engines	60 000	460 000
Conducting transportation		2,320 000
General expenses		1,000 000
		$4,200 000

STATISTICS OF OPERATIONS

MILES OF RAILWAY OPERATED 800

Passenger-train mileage	1,800 000
Freight-train mileage	3,200 000
Switching, etc., mileage	1,000 000
Total engine mileage	6,000 000
Number of passengers	800 000
" " " 1 mile	36,000 000
Tons of freight	3,000 000
" " " 1 mile	700,000 000
Rate of fare per mile, in cents	.03
Rate of freight per ton per mile, in cents	.008
Mileage of passenger and baggage cars	9,000 000
Mileage of freight cars	96,000 000

GENERAL ITEMS

Maintenance of way per mile	$525		
Average number of passengers to each train mile			20
Average number of tons to each freight train mile			220
Average number of passenger cars to each train			5
Number of freight cars to each train			30
Average mileage of each freight car per day			10
Average earnings per mile:			
each passenger train		$0.60	
each freight train		1.75	
Cost of motive power per engine mile:			
Repair of engines	$0.01		
Fuel	.05		
Engineers and firemen	.07		
Oil and waste	.01	$0.14	

Railway reports do not always give just these statistics, but usually the information we need can be obtained by a little figuring. The cost of maintenance of way per mile is easily ascertained by dividing the average number of miles operated into the total payments for that account. The average number of passengers or of tons of freight to each train is found by dividing the train mileage into the number of miles travelled by passengers or the tons one mile, respectively. The results are, therefore, somewhat in the abstract, but they afford the best comparison regarding the economy of the train service, one of the most important things to be considered in judging railway properties. It is necessary to

know the number of miles run annually by cars, freight cars especially, in order that we may check the construction account and judge of the general efficiency of the company's management.

The amount allowed for maintenance of way is too small for the volume of traffic and number of trains. The sum varies from $2000 per mile in the case of our principal roads, downwards. Generally this item is best judged by comparing the amounts spent per year for a number of years with those spent by neighboring companies similarly situated. On many railroads the average annual cost of necessary repairs and renewals is $500 on each passenger coach, $40 each for freight cars, and $1000 each for engines. Multiplying these averages into the list of equipment given above, we find that there should be an addition of over a million dollars to the sum allowed in the operating expenses for repairs and replacement of equipment. This, of course, would increase the total expenses by that amount and correspondingly decrease the net income. As we know that the Great Eastern Railway (or any railway) cannot long be run without making the repairs and renewals its neighbors find necessary, we are forced to the conclusion that if money enough to care rightly for the property has been expended and charged to current working expenses, the fixed charges might not have been earned. Bankruptcy, therefore, awaits the company, unless heroic measures are taken to remedy defects in management and save the property. The decline in the market prices of the stock was more than warranted. Our inquiring stockholder would do well to dispose of his holdings at once at whatever price he can get; unless his ownership is so large and his knowledge of railway operation so good as to enable him to ascertain and himself apply the proper remedy.

We have not yet exhausted comment on these tables. The cost of fuel (five cents per engine mile) is not high; and if we add two or three cents to the cost of repairs for locomotives, the cost of motive power, per mile run, is low,—a point much in the company's favor. The rate received per ton per mile is not high, and perhaps a careful examination of the commercial conditions of the country through which the road runs would show where improvement is possible. The passenger department is grossly mismanaged. So many trains are run that the average number of passengers is only twenty per train mile. The average for the whole United States is about forty-five, and to carry less than thirty-five passengers per average mile is hardly profitable. Trains should at once be

withdrawn until only the reasonable demands of the public are met. Since only half the present number of passenger cars is really needed, it was a gross abuse of power for the management to purchase more coaches, as the construction account shows they did. There is no particular fault to be found with the lading of the average freight train or with the earnings per freight train mile; they are up to the average, if not beyond it. But to what use so many freight cars can be put is a mystery. It appears that the average mileage of the freight cars is but ten miles per day; it should be at least three times that number to be profitable. The daily mileage of each freight car on the average is found by dividing the total freight-car mileage by the number of cars. Nine or ten thousand miles per year is the expected work of each freight car on the average on a successful road. Very likely more than half of the large number of cars owned (large in proportion to traffic carried) are standing idle on side tracks. The construction account showed 1000 cars bought at an expense of $500,000. Not a single car should have been added to the list, since under good management one third the number already owned should carry the stated volume of business. The extra number of cars should be reduced or loaned out to other roads, to be paid for at the standard rate for use of foreign cars, about three fourths of a cent per mile run. It sometimes happens that an unscrupulous company will charge renewals of equipment to capital and conceal the fact by adding the new cars to the old list of a year ago, even though it may not have in service the number of locomotives and cars certified to in the report; such unjustifiable additions are called "vacant numbers." Vacant numbers sometimes arise from the destruction of worthless cars which should be replaced from operating expenses but temporarily are not, because of hard times. This is a legitimate economy if so stated in the report; though it is better to charge against income the estimated cost of filling the vacant numbers. If the mileage of freight cars is stated in the report, these juggles with equipment, when at all serious, can be detected. If the company is really short of cars the cost of hiring equipment (itemized in the detailed table of operating expenses) will be a large and increasing sum. If more cars are, for the purposes of deception, kept in the lists than are actually runing, either because old cars have been broken up and not replaced or are allowed to stand in the yards though worthless, the fact will be revealed by dividing the number of cars into the total mileage. If this total mileage

includes foreign cars, such foreign mileage must be deducted and the mileage of home cars on foreign roads added. If, as in the Great Eastern case, the whole freight equipment ran an average of but 3200 miles during the year, when the average should have been 9000 miles or more, there is serious mismanagement or fraud. There has therefore been gross mismanagement or fraud also in locking up capital by the purchase of unnecessary equipment, which when bought must be kept in repair though perhaps falling to pieces through lack of use. In view of these latter criticisms it is probable that all the items in the construction account should receive careful investigation. The amount allotted to general expenses on a road carrying a fair amount of traffic should be not much over ten per cent. of the total expenses. Judged by this test the Great Eastern managers may be wasting about $500,000 a year. In short, the directors of this company are either "working" the road for their own benefit, or are culpably negligent of their duties as trustees for the stockholders.

It is often of importance to find out whether a company has much ready cash or is likely to be obliged to borrow for interest or dividends. An estimate upon this point is possible. Taking the balance-sheet given for the last fiscal year of the Great Eastern Railway on a former page, we find the cash items as follows:

Quick assets.		*Quick liabilities.*	
Due from connecting roads..	$200 000	Due connecting roads.....	$1,000 000
Accounts receivable........	300 000	Due for wages...........	700 000
Suspense accounts.........	200 000	Unadjusted accts.........	300 000
Cash and cash items.......	100 000	Bills payable............	1,000 000
		Supply accts.............	300 000
		Vouchers................	200 000
	$ 800 000		$3,500 000
Excess of debts......	2,700 000		

Very likely the true state is a little worse than this, for while "unadjusted" or "suspense" debts must usually be paid in full at some time, accounts receivable or in suspense often cover items carried along in this way from year to year, and in part at least worthless or unavailable. The real cash resources as indicated in the above statement may be fairly set down as not more than half the sum stated, or $400,000. The item of accrued interest ought also to be included in the pressing debts, if the actual day of pay-

ment is near at hand—as, for example, July 1st, when the fiscal year closes June 30th. Materials and supplies, properly carried in the balance-sheet as assets since the company's working capital is invested therein, are not available for the payment of current debt and are therefore excluded from our table. A glance at the balance-sheet shows that the only treasury assets which can be sold are the bonds of the Rich Valley branch, amounting to $5,000,-000. It is doubtful under our showing whether these bonds could be sold at a heavy sacrifice, if at all; for an investigation would reveal the fact that the bonds were really dependent for their value upon the success of the system, since the branch line itself is not earning the interest. A proper inquiry at this point would be whether the Rich Valley is commercially entitled to a larger proportion of the combined earnings; if so, its bonds would be enhanced in value, though the enhancement would be at the expense of the earnings of the main line.

Of course, the selling of Rich Valley bonds in the Great Eastern treasury would only exchange one form of debt for another, and would not therefore relieve the real situation. The company's affairs require thorough overhauling. Yet the fact that a company in temporary difficulties has in its treasury bonds available for sale, is often important. The obligation is changed from a floating to a funded debt, and therefore relieves the company from the fear of a receivership. Yet such a change really avails nothing in the long run unless the business or the management changes with it in such a way as to insure a greater success. The affairs of the company look desperate; it is doubtful whether such an entanglement could be straightened out without a receivership for a few years, long enough to enable the pressing debts to be liquidated without too much sacrifice of the company's assets. Nevertheless, we see that in spite of gross mismanagement there is a good traffic, which in capable hands could be made to earn a fair revenue. We will, therefore, assume that indignant shareholders turn out the board of directors and discharge the officers, substituting capable and honest men. Let us suppose new directors and officers in charge. Of course the payment of dividends is suspended and all energies are devoted to saving the property from foreclosure. In such large affairs, all that is wrong cannot be righted at once. Corporate salvation is a work of time. In the present case we will assume that money could be borrowed to meet pressing needs, that two or three years' hard work has had its results, and that the income of

the road is now meeting in full all proper operating expenses and fixed charges. Under these conditions the income account would be as follows:

Gross earnings: passenger		$2,000 000
freight		7,000 000
mail, express, and miscellaneous		600 000
Total earnings		9,600 000
Operating expenses (70 per cent.)		6,745 000
Total income		2,855 000
Fixed charges: taxes	$150 000	
bond interest	1,500 000	1,650 000
Net income		1,205 000
Deduct loss on Rich Valley bonds outstanding	$350 000	
Deduct amounts set aside to pay interest and principal of old floating debts	350 000	700 000
Surplus for year, devoted to improvements and betterments		$505 000

This is very satisfactory. Passenger earnings have increased by the judicious issue of commutation and excursion tickets, though the fare received on the average has fallen from three cents to two cents per mile. In the intervening years the new officers have increased the volume of traffic. Taxes and bond interest have increased, and the losses on the Rich Valley branch are now properly charged. Evidently also the new management has adopted the policy of paying off old debts by degrees, $350,000 being set aside for that purpose. There still remains a surplus of $500,000, which is to be spent for improvements on the property. Altogether there is a fair prospect of resuming dividends, so that those who purchased the stock when at its lowest point will very likely make large profits.

For the sake of contrast, the details of the operating expenses are given:

Maintenance of way		$1,000 000
Maintenance of equipment:		
400 passenger cars at $500	$200 000	
15,000 freight cars at $50	750 000	
200 engines at $1000	200 000	1,150 000
Conducting transportation		4,095 000
General expenses		500 000
		$6,745 000

STATISTICS

Miles of railway operated, 800.	
Passenger-train mileage	2,500 000
Freight-train "	3,600 000
Switching "	1,200 000
	7,300 000
No. of passengers, one mile	100,000 000
Tons of freight, one mile	900,000 000
Rate of fare in cents per mile	.02
" " freight " " "	.008
Mileage of passenger and baggage cars	12,000 000
" " freight cars	150,000 000
No. of passengers to each train	40
No. of tons of freight to each train	250

A generous amount is allowed for maintenance; when the plant is once in excellent condition, it can be maintained at a less cost than that here given. The expense for trains earning revenue (this phrase excludes switching mileage and the like) is about $1 per train mile. In actual operation, this expense runs from eighty cents upwards per mile run, varying according to conditions, particularly the relative cheapness or dearness of coal, which forms a large item in all railroad expenses. As we have assumed that the Great Eastern Railway obtains its fuel cheaply, the assumed cost per train mile is fair, indicating reasonably high expenses for improving the property if the management is good, or a waste of money if the management is bad. Under the old state of affairs on this railway, the expense per train mile was about eighty cents. Our examination of details showed that this old appearance of cheapness was deceptive. Whether the new cost of about $1 per train mile is due to a generous care of the property or to greater waste, can be told only by further scrutiny into the accounts.

The table of statistics enables us to judge of the new management, and by contrast with the old figures shows important differences. The number of locomotives and passenger cars is the same as before. These have been presumably kept in good condition, the amounts allowed in the new operating estimates being fairly large. Freight cars have been reduced one half, partly by sale and partly by the breaking up of old and small cars which were uneconomical to use. The new management had to do the best they could with the property as they found it when coming into power. The number of passengers per train has doubled, showing more careful study of that part of the corporation problem. Nothing has been added to capital account, but the policy has been in-

augurated of setting aside certain sums for the payment of outstanding unfunded debts. The old traffic of the company was large enough to furnish a good basis for the present better condition; the question was one of management exclusively. . . .

It has been the purpose of this chapter to show that any one with a fair knowledge of railroad operations can find out for himself the broad facts concerning any company, provided sufficient details are given in the annual reports, and provided he will take the trouble to examine them closely. It is a mistake to suppose that nothing can be ascertained from the annual reports of railways; the main facts can be. It is often thought that the figures can be manipulated, and so made worse than useless; this is true, but only to a certain degree. The items in a railway report are interdependent in a way often unsuspected. For example, if bonds have been issued or bills payable contracted, some item or items on the other side of the balance-sheet must be increased also. The inquirer should then proceed to look into such items of assets with a view to finding out whether such increases are legitimate, and if so, whether they commend themselves to his judgment. Charges to capital should be scrutinized carefully, with a glance at the items allowed for maintaining roadbed, track, and equipment to see whether these have been neglected. Comparison should always be taken with a road similarly situated, and more than one year's work should be tabulated. . . .

CHAPTER XIX

FINANCIAL INVESTIGATIONS BY THE INTERSTATE COMMERCE COMMISSION [1]

The act to regulate commerce gave to the commission, created by it, authority to inquire into the management of the business of interstate common carriers. No limitation upon the scope of inquiry so long as it concerned the management of the business of carriers subject to the act would appear to have been imposed. Under this authority, the Interstate Commerce Commission has apparently had power, at any time during its existence, to investigate not merely rates and traffic regulations but also any matters concerning operation and fiscal administration that it chose to be interested in. However, this large investigative power was allowed to lie more or less in abeyance, so far as the last mentioned aspects of railway management were concerned, for twenty-five years or thereabouts. To some extent, it was incapable of effective utilization on account of the failure of the original act to provide sufficiently complete control over traffic and fiscal records and accounts or adequate machinery with which to pursue inquiries of this kind. The Hepburn amendment of 1906 remedied this by definitely assigning to the commission such control and by authorizing the employment of special agents or examiners with full powers of investigation.

The half-dozen years immediately following the enactment of the Hepburn amendment were employed by the commission in molding into uniform pattern the myriad-shaped accounts of the carriers and in organizing a corps of inspection to assist in this desirable simplification. By 1912, the commission evidently felt itself in a position to make use of its strengthened facilities of inquiry, and, with admirable courage, determined to try its hand upon no less important a corporate body than that of the New York, New Haven and Hartford Railroad Company, including its ancillary member, the Boston and Maine Railroad.

[1] From Ernest Ritson Dewsnup, "Recent Financial Investigations by the Interstate Commerce Commission," *Annals of the American Academy of Political and Social Science*, vol. 63, pp. 199–213 (January, 1916). Reproduced by permission. See Jones, pp. 318–321.

For some time prior to the investigation undertaken by the commission in 1912, there had been severe criticism of the operating and financial methods of the New Haven system. The investigation, into which the commission entered as the result of an informal inquiry by one of its special agents, turned out to be a most extensive one, the hearings consuming thirty-seven days and resulting in over six thousand pages of type-written testimony. The report of the commission published in the summer of 1913 [1] stirred the interest of Congress, and, in the following February, the Senate passed a resolution instructing the commission to re-open the examination of the affairs of the company and to make further investigation of its financial transactions. In accordance with these instructions, a still more intensive examination was undertaken, in the course of which nearly forty persons were placed upon the stand—their testimony and the exhibits in connection with the case requiring two thick volumes for their printed presentation.[2]

Very soon after the election of Mr. C. S. Mellen to the presidency of the New Haven road, that company proceeded to extend its control of trolley lines in southern New England by bold and hazardous steps. To this end it organized the Providence Securities Company which exchanged its 4 per cent debentures, guaranteed by the New Haven road, for the whole of the securities of the Rhode Island Securities Company, a company which the United Gas Improvement Company of Philadelphia had organized, in July, 1902, to hold the capital stock of the Rhode Island Company, the last named being the operating company (organized in June, 1902) controlling, under 999-year leases, about two hundred and forty miles of trolley lines in Rhode Island. The cash investment of the last named company appears to have been but little over nine and one-half million dollars but, in its determination to secure a monopolistic grip of the trolley situation, the New Haven spent in money and securities over twenty-four million dollars, an astounding expenditure in view of the fact that from the organization of the Rhode Island Company until its purchase in 1906, it had failed to pay a dividend; indeed, its income account showed a surplus of but $397,000 up to June 30, 1908. It was part of the agreement with the United Gas Improvement Company that the New Haven should also take over the Connecticut trolley lines,

[1] *27 Interstate Commerce Commission Reports*, pp. 560–617. The New England Investigation.

[2] 63d Congress, 2d session, 1913–14. *Senate Documents, vols. 19 and 20.*

and here again a sum was paid considerably in excess of their value—$10,000,000, according to former president Mellen's testimony.

That the New Haven management was prepared to make the most extravagant expenditures in its endeavor to suppress competition is further illustrated in its acquisition of the New York, Westchester and Boston Railway Company, a property which ultimately cost it nearly thirty-six and one-half million dollars for a line of eighteen miles in length. The acquisition was undertaken by a special committee with power to act, composed of J. P. Morgan, William Rockefeller and G. M. Miller, with President Mellen *ex-officio*. This committee was appointed by the standing committee of the Board of Directors after Mr. Mellen had made a statement concerning the "proposed competition between the Connecticut State line and the Harlem River." Five days later (September 22, 1906), this action was approved at a regular meeting of the full Board, fifteen of the directors being present. The report of the Interstate Commerce Commission states that the full Board was not taken into the confidence of those directors who wanted the Westchester securities purchased. However, the testimony seems to indicate that, in appointing this committee in such general terms, the directors were aware of the purpose of their vote, though not anticipating so heavy a purchase price as was actually paid.

Some thirteen months later, the Morgan-Rockefeller committee reported to the Board that it had secured control of the properties at a cost of more than eleven million dollars. For this large expenditure, the New Haven became the possessor of two "beclouded" franchises for lines parallel and in close proximity to its own tracks. The tangible assets underlying the Westchester and Port Chester companies and the City and County Contract Company (the construction company), at the time of the acquisition of the property by the New Haven, would seem to have been about four million one hundred and sixty thousand dollars. Both franchises were being attacked in the courts and an application for permission to consolidate the two projects and construct but one road was held up by court injunction. To straighten out the legal tangle and to secure the necessary amendments to the franchises, President Mellen, with the aid of the late Thomas J. Byrnes, sometime inspector in the New York police force, expended an additional $1,500,000, the trail of this expenditure being hidden by

the transfer of New Haven securities to its subsidiary company, the New England Navigation Company, which thereupon transferred them to its President, who happened to be the same C. S. Mellen that presided over the parent company. The outlay of this money secured for the New Haven road the control of 30,431 of the 34,053½ Westchester shares still outstanding, worth, as Mr. Mellen cynically testified later, about ten cents a pound. The Interstate Commerce Commission, in its report, had no hesitation in charging a corrupt purpose in the manipulation of this expenditure. In addition to the above payments, a further $1,400,000 was paid out in settlement of the claims of parties in control of the Port Chester Company, and of the damages accruing to Thorne and Perry (who had been acting as agents for the New Haven in securing the property) on account of the rescission of their contract. In the course of the investigation by the Commission, it seems that Thorne and Perry failed to account for $1,032,000 of the moneys expended by them.

Thus it appears that the Morgan-Rockefeller committee of the New Haven Board was responsible for disbursing over fourteen million dollars for tangible assets, as already stated, of a little over four millions. To complete the construction of the road, $22,000,000 was required, thus making $36,000,000 in all, the fixed charges involving a payment of $1,250,000 per annum beyond the earnings, and according to the testimony of the President of the road, the earnings at the time of the investigation were less than 25 per cent of the amount necessary to make the property self-sustaining. Such finance savors of monopoly mania. That such eminent financiers should have been responsible for it makes the matter only the more astounding. To judge from Mellen's testimony, the relation of the highly paid President of a most important railway company to the late J. P. Morgan resembled nothing more closely than that of the office boy to his "boss." The evidence does not reveal the underlying purpose of Mr. Morgan in putting this deal through and it might be said that, in reply to a direct inquiry from the present chairman of the New Haven, the firm of J. P. Morgan and Company asserted that in the course of the twenty years prior to December 4, 1913, they realized a total net profit of not more than approximately $350,000 from the handling of the securities of the New Haven and its subsidiary companies.

The Billard transactions afford another example of the New Haven's financial extravagance, as also of its defiance of statutory

regulation. The space at our disposal will not permit us to enter into detail, but, in brief, these transactions arose out of a decision of the Supreme Court of Massachusetts which made it very clear that in acquiring a substantially controlling interest in the Boston and Maine Railroad, in 1907, the New Haven had acted illegally. The stock had been acquired in the name of the New Haven's subsidiary, the New England Navigation Company. Accordingly, the New Haven proceeded apparently to divest itself of the property by having the Navigation Company sell the stock to a Mr. John L. Billard. However, within about a year after this sale, the New Haven succeeded in securing the passage of a bill by the legislature of Massachusetts authorizing the incorporation of the Boston Railroad Holding Company with power to acquire and hold a majority of the stock of the Boston and Maine Railroad (June 24, 1909). Thereupon, Billard was induced to sell back the stock to the Navigation Company which transferred it to the new holding company. But when investigation came to be made, it was obvious that at no time during the couple of years covered by these transactions had the New Haven really relinquished its control of the Boston and Maine. Billard, a coal merchant of Meriden, Conn., was by no means in a financial condition to handle such a large deal. Actually he did not put out a dollar of his own money. He did not even handle the shares. The $13,750,000 representing the purchase price was raised by an advance of $11,000,000 by the National City Bank of New York, on the stock deposited as collateral, and the balance of nearly two and three quarter million dollars was then taken care of through the acceptance by the Navigation Company of an unsecured note of Billard's. Nevertheless, Billard would seem to have pulled $2,748,000 out of the business, for the securities were sold to him at $125 and bought back at $150 per share, and this despite the understanding of the Board of Directors of the New Haven that Billard was to receive only a reasonable compensation for the service he performed. Billard, by the way, took care to burn his books and papers, presumably to avoid embarrassment from any examination of them.

The monopolistic ambitions of the New Haven management extended not only to control of electric trolleys and suburban and main line railroads, but also to that of water communications. Adopting its usual methods of "dummy companies and dummy officers and directors," the railroad acquired control of half a dozen

of the leading steamship lines of New England at a total cost of nearly twenty-five million dollars for property with a physical valuation of about ten million dollars.

Space will not permit a description of the questionable practices of the New Haven in the manipulation of its accounts, of its advances to subsidiary companies to enable them to pay dividends which in turn were credited to the former road in its income account. The commission states that

> the accounts of the company are replete with instances in which profits have been declared to be earned by the transfer of stocks, bonds, and debentures, and securities of one of the subordinate and subsidiary companies of the New Haven system, to another such subsidiary, and such profits are solemnly recorded as real profits in working up the accounts of the system as a whole.

Purchases of supplies to large amounts were made without bids, and frequently from companies having men as directors who were also on the Board of the New Haven. Lavish contributions to both political parties were made, large sums were expended to "educate" public opinion; one well known professor of law in New England was paid $10,000 a year, besides payments to his brother and father of $25 and $50 a day.

The commission estimated that the loss to the New Haven Company through waste and mismanagement, amounted to between $60,000,000 and $90,000,000, the burden of which will be a heavy drain for many years upon its resources. Undoubtedly, the present management, under the very capable direction of Mr. Howard Elliott, in whose unimpeachable honesty the public has every confidence, will ultimately be able to restore prosperity to the undertaking, but the task will be a difficult one. The new administration, before the opening of the investigation ordered by the Senate, had already entered into an agreement with the Attorney General of the United States to divorce the New Haven Company from the Boston and Maine, the trolley lines, and most of the steamship lines, and certain other steps had also been taken to free the company from the responsibility of those subsidiary companies whose association with it had been criticized.

Just about the time that the first New Haven investigation was drawing to a close, and before the commission had issued its report thereupon, one of the well-known western railways, the St. Louis and San Francisco Railroad Company, along with its subsidiary, the Chicago and Eastern Illinois Railroad, went into the

hands of receivers. The receivership caused a good deal of comment and finally led to resolutions by the United States Senate, in the following June and July, instructing the commission to report to that body all the facts connected with the purchase of the Chicago and Eastern Illinois Railroad, and the St. Louis, Brownsville and Mexico Railroad by the Frisco company, and also with the subsequent receiverships. The testimony secured for this report [1] evidenced a policy on the part of the Frisco management that was marked by a high degree of financial recklessness. It seems that, between 1897 and 1907, the Frisco undertook an extensive program of acquisition of new lines, constructed by syndicates with the probable understanding that the former would purchase them after completion. There is some evidence to show that the prices paid for these properties netted large profits to the subscribers. Officials of the Frisco, including the chairman of the Board of Directors, seem to have participated freely in these dealings. A somewhat spectacular example of Frisco financing occurred in the case of the South Texas lines. In its endeavor to secure a through coast route between Brownsville, Texas, and New Orleans—a rather remote traffic interest—the company advanced $33,000,000 for the construction of lines and the acquisition of control of existing companies. The loss to the Frisco on these transactions, including discounts, commissions and an unliquidated sum of $5,000,000 due to it by the New Orleans, Texas, and Mexico Railroad, amounted to more than eight million dollars. Neither the Brownsville line, nor the New Orleans, Texas and Mexico has met its fixed charges since 1910.

Prior to this, the Frisco had heavily involved its credit in gaining control of the Chicago and Eastern Illinois Railroad. The basis upon which the latter railroad was acquired in 1902 made it essential that the Frisco should receive regularly dividends of 6 per cent on the preferred stock and 10 per cent upon the common stock of the Chicago and Eastern Illinois, in order to pay the interest charges on the stock trust certificates with which it had obtained the securities of that company. Actually, the dividends paid by the common stock were insufficient to meet the interest charges, and, to May, 1913, the Frisco had suffered a loss thereupon of over two million dollars or, deducting the interest on the stock certificates owned by it, a net loss of $1,710,000. After December, 1911, the subsidiary road ceased to pay any dividends at

[1] *29 Interstate Commerce Commission Reports*, pp. 139–211.

all. The price paid by the Frisco to secure this line of entry into Chicago seems to have been an extravagant one when comparison is made with the dividend earning power of the Chicago and Eastern Illinois prior to the acquisition.

An optimistic view of the effect of the Frisco alliance upon the earnings of the Chicago and Eastern Illinois was responsible, perhaps, for the cheerfulness with which the Frisco undertook the financial responsibility. Indeed, there was a notable increase in the gross operating revenue of that road from $6,000,000 in 1901 to $15,000,000 in 1912. But the management was not successful in achieving economy; the operating expenses increased with striking rapidity (fourfold), and the operating ratio rose from 54.75 to over 80 per cent. The increased cost of materials and labor does not constitute a sufficient explanation of such an increase.

In assigning causes for the Frisco insolvency, the commission laid emphasis upon the disproportionate amount of funded indebtedness, the acquisition of new lines, the financing of the South Texas lines, the Chicago and Eastern Illinois deal, sale of securities at low prices, payment of unearned dividends on preferred stock, investment in stocks of non-dividend-paying industrial companies, and payment of excessive charges upon the investment in and use of terminal and coal properties.

Less than two months after the report upon the Frisco situation, the financial methods of the management of one of the great and supposedly carefully administered railway properties of the middle west were brought to the attention of the public in the report of the commission upon the Chicago, Milwaukee and St. Paul Railway Company.[1]

To bolster up the income of the St. Paul road for 1910, the income account of that year was made to include all the interest, rents and revenues, over four million six hundred thousand dollars, arising out of the construction of the Puget Sound road in previous years. At the same time, operating expenses were given an artificial decrease of more than five hundred thousand dollars by crediting to the current year the salvage of cars destroyed previous to July 1, 1909. Since they had not been taken care of previously, these items should have been handled through the profit and loss account. After the Puget Sound road had been opened, construction of branch lines, etc., still continued to be active, and, according

[1] *29 Interstate Commerce Commission Reports*, p. 508.

to the accusation of the commission, large amounts that should have been charged as expenses of operation were entered under the head of cost of construction. Furthermore, notwithstanding the requirement of the commission, laid down in the classification of operating expenses issued in 1907, that depreciation should be annually charged on equipment, the accounts of the company failed to show any such provision. These accusations constitute a lamentable indictment against the St. Paul of endeavoring to deceive its stockholders and the investing public as to the true financial status of the company. By the artifices above mentioned, the Puget Sound road was enabled to contribute a 2 per cent dividend towards the St. Paul's dividend of 1911, thus enabling the latter company to make a fictitious showing of a dividend earned entirely out of current income.

The overstatement of income for the year 1909–10 led to a book decrease in revenue and income, during the following year, of more than two million dollars, which the company's report explained as due to its inability to obtain increased rates, and the great increase in the cost of labor. Actually, the wage bill of the St. Paul for 1910–11 was nearly fifty-six thousand dollars less than that for 1909–10.

The balance sheet of the Puget Sound road was also distorted to the extent of showing a property investment of $100,000,000 greater than was actually the case. As explained by the president of the St. Paul, the directors of that company were unable to accept the stock of the Puget Sound road as the binding security for the advances made to the latter, and so they had that company issue first mortgage bonds approximating in amount the $200,000,000 of constructional cost. But the law of the state of Washington, under which the Puget Sound road was incorporated, forbade the issue of funded debt beyond twice the amount of capital stock. To meet this requirement, this company had to issue to the St. Paul an additional $100,000,000 of stock, which was carried on the books of the parent company at merely a nominal value. The explanation, though it makes clear that in this matter there was no intent to deceive, was a very lame and unsatisfactory one. An accounting could have been made in accordance with the commission's regulations that would have shown, on the Puget Sound balance sheet, a discount on securities sold of the $100,000,000 of stocks issued less the nominal amount for which this was carried on the St. Paul balance sheet, the item being entered under de-

ferred assets; or an explanatory note could have been attached to the balance sheet explaining the reason for the irregularity.

The most recent of the financial investigations of the Interstate Commerce Commission has been that into the condition of the Chicago, Rock Island and Pacific Railway Company, the final hearings in connection with which were held last June [1915].[1] The acquisition of the control of the Rock Island in 1901 by Reid, Leeds and the two Moores, the subsequent organization of the two holding companies, the Chicago, Rock Island and Pacific Railroad Company of Iowa, and the Rock Island Company of New Jersey, with a capitalization of $200,000,000 for the former and of $150,000,000 for the latter, the concentration of control in the preferred stock of the New Jersey corporation, all these matters are familiar to the reader and need not be rehearsed here, but there are certain less familiar facts that deserve attention here since they throw a lurid light upon the possibilities of financial manipulation by such men as those already named.

Apparently, the rights of the stockholders in the earnings of the company were deemed of little account. Salaries shown on the payroll were supplemented by secret allowances and bonuses. Presents of considerable sums were made to both officers and members of the Board of Directors. About a million dollars was distributed to officials of the railway company in excess of their salaries. Irregular payments were made for "supporting the market, while the bonds of the railway company were being sold," for contributions to campaign committees, for rebates to a Denver newspaper, for securing discontinuance of a line of road being constructed between Peoria, Illinois, and Clinton, Iowa.

Misrepresentation of assets was made unblushingly. As late as June, 1914, the railway company carried an amount of nearly six million, two hundred thousand dollars as surplus, based upon: (1) a book value of nearly three and three-quarter million dollars ascribed to the securities of the Trinity and Brazos Valley Railway, a company then in the hands of receivers; (2) a book value of $6,000,000 of Clover Leaf bonds, secured only by Chicago and Alton Railroad stock having a current market value of little more than one and one half million dollars; (3) a book value of $200,000 of the stock of a Nebraska railway company and a construction company that had no existence except on paper; (4) a book value of nearly six million dollars attributed to the worthless five per

[1] *36 Interstate Commerce Commission Reports*, pp. 43–61.

cent debenture bonds of the Iowa holding company. As pointed out by the commission, a proper valuation of assets would have changed the so-called surplus into a deficit of nearly twelve million dollars.

In geneıal, financing operations of the Rock Island management seem to have been distinguished by anything but business acumen. When the fear of action under the Sherman law caused the divorce of the combined Rock Island-Frisco interests, the sum realized by the sale of the Frisco stock, which had been deposited as collateral for the bonds of the Iowa company, was insufficient to redeem the latter, but the Iowa company, with no resources of its own, issued seven and one-half million dollars worth of bonds to the Chicago, Rock Island and Pacific Railway, almost at par, the latter raising the cash by a bank loan. One million, three hundred and eighty-eight thousand dollars' worth of these bonds was retired later, but the remaining $6,112,000 was unable to be retired by the Iowa company as it had no assets. The Rock Island's investments in the stock of the Chicago and Alton Railroad ended in a loss of over six million dollars. Its agreement with the Colorado and Southern for the financing of the Trinity and Brazos Valley Railway also ended unfortunately. Advances of nearly three and three-quarter million dollars were made, upon which unpaid interest had accrued, to June 30, 1914, of another three-quarter million dollars—in a property whose annual income accounts have been replete with deficits and which finally went into the hands of a receiver.

The incorporation of the Consolidated Indiana Coal Company, in April, 1905, was made the occasion for paying, out of the treasury of the railway company to the general counsel of the latter, a $30,000 a year official, the sum of $10,000 for drawing up the incorporation papers. The railway guaranteed the coal company's bonds, and in consideration thereof received $2,400,000 (out of $3,400,000) capital stock. To June 30, 1914, the railway company had advanced $2,354,000 to the coal company, and, since 1910, unpaid interest has amounted to more than four hundred thousand dollars additional.

Other curious transactions might be mentioned, as, for instance, that in which the railway company sold bonds of the Rock Island Improvement Company (a subsidiary of the holding companies organized to acquire transportation equipment and facilities for the railway company) at less than par, only to buy them back at more than par some six months later.

The ultimate result of the Reid-Moore syndicate was to throw the railway into a receivership. Here again, apparently, the sinister nature of the syndicate's policy is perceptible. It seems pretty clear that the railway could have arranged to meet all its pressing obligations, in spite of the growing unsatisfactoriness of its financial condition, but the syndicate wanted a receivership, presumably for purposes of its own, and, without the knowledge of and regardless of the interests of the stockholders, and without acquainting the representative of the minority stockholders on the Board of Directors of its intention, made application to the court. The bill for receivership seems to have been completed by the general counsel of the company on March 29; though this fact was known only to a select few. It is worthy of notice that, between that date and the date of filing, April 20, the stock of the railway company began to be largely dealt in on the market. The suspiciousness of this is undeniable but there is no absolutely conclusive evidence that the Reid-Moore people helped to create the artificial price that was reached on the Exchange. The editor of the *Railway Age Gazette* expresses his opinion, which, though not conclusive, is worthy of respect, that this whole stock movement looked "far more like an attempt of a clique of comparatively small speculators to put up the price than any attempt on the part of the controlling interests to make a market on which they could unload their holdings." However this may be, a more reprehensible example of financial jugglery, incompetence and heartless disregard of the interests of investors than that of the Reid-Moore administration would be hard to find. The syndicate took hold of a property whose shares were valued at $175 and upwards on the market; by the time their manipulations were completed, the shares were selling at a mere ninth or tenth of that value, and for no small part of that decrease the syndicate must be held responsible.

The above recital of the facts disclosed by the inquiries of the Interstate Commerce Commission speaks for itself. Disillusionment must surely have come to many who have had unquestioning confidence in the supreme ability and unerring foresight of our statesmen of private finance. There has been too great a tendency in financial circles to place the responsibility that legally accrues to each individual taking part in the management of industrial enterprises upon the shoulders of ambitious colleagues. Of course, the individual of unusual ability will always be able, and it is desirable that he should be able, to exercise a powerful influence

upon the management. But this should not and must not be allowed to justify improper and dangerous concentration of power through the neglect of directors to direct.

Our present type of railway directorate, and no doubt this applies to other fields of industrial administration, needs reorganization. The example set by the government in its prosecution of eleven directors of the former New Haven régime will have a salutary influence in this direction. Every effort should be made to hold directors to a strict accounting for maladministration of property committed to their care. Such a policy, vigorously pursued, would undoubtedly lessen the inclination of directors to treat their responsibilities as merely nominal. There would be fewer instances of plural directors, physically incapable of keeping close supervision over the managerial policies of their various companies. Railway companies would be well advised to restrict the number of directors upon their boards, and to see that each directorate is composed largely of men in close touch with their properties. It should be made obligatory upon every interstate common carrier to place, after the name of each director in the annual report not only his place of residence but also the amount of his bona-fide stock holdings in the company, and there should be included in the report a tabular statement, based upon the individual affidavits of the directors, showing for each director his holdings of securities in other common carriers.

Each annual report of interstate common carriers should be required to state in as plain a form as practicable not only the nature and amount of all securities disposed of during the current fiscal year but also the nature and amount of expenditures made out of the resulting funds. In the case of properties purchased outright or in which a controlling interest has been acquired, the amount paid in cash or securities or in both should be specified and a brief description given of the property acquired and of the purpose of acquisition. Corresponding information should be furnished in the case of leases. A statement of all guarantees of interest or dividend payments assumed should be given. It is satisfactory to note that a good deal of this information is now included in the reports of, at any rate, the larger companies.

To facilitate more exact assessment of the standard of maintenance maintained by each railway administration, there should be required in each annual report: (1) a record of the main classes of equipment, with the average age of each class; (2) a record of

track conditions, specifying the proportion of heavy and light rails, mileage of ballast of each class, subclassified so as to show depth of ballast, number of treated and untreated ties, with average number of years already in track; (3) a structural report classifying the main structures according to their component materials.

The above measure of protection to investors represents as far as it is wise to proceed at the present, probably, for, despite the powers enjoyed by the commissions of certain states, it is doubtful whether the Interstate Commerce Commission, or any other governmental agency, is in a position to control effectively and safely the issue of railway securities. But the strictest scrutiny of all financial transactions of the larger interstate carriers should be maintained and no hesitation felt in holding a public inquiry where the situation seems to call for it. However, as between federal and state control of securities, there need be little hesitation in preferring the former.

It is but proper to say that the opinion of the commission, as expressed in several places, but most fully in its report upon "The New England Investigation," is that adequate regulation of interstate railroads is impossible without national control of their issues of stocks and bonds, as well as all leases or purchases of one railroad by another, all acquisition of securities, all guarantees, and, furthermore, that no interstate railroad should be allowed to expend money or incur liability or acquire property "not in the operation of its railroad or in the legitimate improvement, extension or development of that railroad." Such an attitude is a very natural reaction after the revelations of its inquiries, and Congress is not likely to need much inducement to approve of it.

CHAPTER XX

REGULATION OF SECURITY ISSUES [1]

1. General Principles [2]

Of all the new powers which the Commission exercises in its finance docket, the regulation of security issues is by far the most drastic encroachment upon corporate management. Many difficult questions of statutory interpretation and of policy remain undetermined in this field of regulation. It is, however, apparent at the outset that through a refusal of permission to issue stocks, bonds, or notes, or by granting such permission upon stated conditions, the Commission could in practice completely control the destinies not only of the railroad corporations, but of the interests of the stock-holders, bond-holders, and mortagees.

Recommendations to Congress by the Commission that it be given control over security issues were originally based upon an investigation which it conducted in 1907 in respect to the acquisition of control of the Southern Pacific by the Union Pacific. The Commission recommended such legislation as a means of curing the evil of "watered stock." Similar recommendations were made in every annual report down to and including the year 1919. Thus, at least in the beginning, the demand for regulation of railroad security issues was a part of the same sort of public agitation which culminated in the enactment of "Blue Sky" laws by the several states.

For thirteen years Congress failed to enact legislation on this subject, although numerous bills designed to accomplish the desired result were introduced and considered. When, in 1920, the Commission's jurisdiction was extended to a regulation of the security issues, it was a part of the comprehensive scheme of railroad regulation of the Transportation Act, 1920, which, as the Supreme Court has said, constituted an entirely "new departure" in railroad regulation. Control of security issues was provided,

[1] See Jones, pp. 268–269, 309–324, 557–558, and Vanderblue and Burgess, pp. 362–371.

[2] From Kenneth F. Burgess, "Federal Regulation of Railway Management and Finance," *Harvard Law Review*, vol. 37, pp. 721–735 (April, 1924). Reproduced by permission.

not as originally demanded to protect the public against "watered stock," but as a necessary part of the program wherein "the new act seeks affirmatively to build up a system of railways prepared to handle promptly all of the interstate traffic of the country."

In the past four years the Commission has approved the issuance of securities to the extent of almost one-fourth of the entire capitalization of the railroads of the United States, it being stated by the Commission in its annual reports to Congress that these "were largely for refunding purposes." Under the new law, approval by the Commission is required of all security issues and assumptions of obligations, except notes maturing not more than two years from their date of issue which shall not aggregate more than 5 per cent of the par value of securities of the carrier then outstanding. The rule laid down to guide the Commission is:

"The Commission shall make such order only if it finds that such issue or assumption: (a) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose."

It is also provided:

"The jurisdiction conferred upon the Commission by this section shall be exclusive and plenary, and a carrier may issue securities and assume obligations or liabilities in accordance with the provisions of this section without securing approval other than as specified herein."

The United States does not guarantee security issues:

"Nothing herein shall be construed to imply any guaranty or obligation as to such securities on the part of the United States."

As thus far administered by the Commission, this grant of power to regulate security issues is entirely restrictive legislation. While the state courts have held that the federal law supersedes the state law to the extent that no license fees may be demanded by the state for permission to issue securities, the Commission has announced that in approving security issues it will be governed by the limitations of state laws:

"Without determining to what extent our power with respect to an issue of securities is affected by the limitation of a state regulation, it is our thought that in this matter we should be governed by the policy of the state law."

By this construction, the Commission gives the most restrictive meaning possible to the requirement that it shall find that the security issue is to be "for some lawful object within its corporate purposes." The corporate charter is thus permitted to define the extreme boundaries of the power of the federal regulation. In effect, this restricts the Act to those purposes which it was originally sought to achieve, the prevention of manipulation and "watered stock," but if this be adhered to it would seem to prevent in large measure constructive results in respect to the building up of interstate commerce which the courts have said Congress sought to achieve through the medium of the Transportation Act, 1920.

As to the power of Congress to restrict corporate action of companies in respect to interstate commerce there can be no doubt. In fact, the carrying on of interstate commerce is not a franchise granted by the state, but is a right which exists in the corporation as a citizen of the United States. And Congress may enlarge the corporate capacity in respect to interstate commerce by granting powers or franchises additional to the charter issued by the state. It may even enlarge the corporate capacity of a state corporation in respect to its intrastate transactions by relieving against a charter obligation to charge no more than a specified rate of fare, as a part of its power to remove unjust discrimination against interstate commerce. The Commission's construction of the present Act, however, makes the corporate charter the test of whether the proposed security issue is "for some lawful object within its corporate purposes." Congress does not seem to have intended this conclusion, judging by the provision in the other paragraph of the same Act that "the jurisdiction conferred upon the Commission by this section shall be exclusive and plenary" and that after such approval a carrier may issue securities without any other approval.

The majority of applications thus far approved by the Interstate Commerce Commission have been handled by Division 4 as matters of routine administration, without formal hearing. In a few cases where there has been a contest or where the applications have presented issues of principle or policy, the entire Com-

mission has participated in the decision, and in some instances there has been serious disagreement as evidenced by the dissenting opinions. These cases may be grouped as: (a) the stock dividend cases; (b) the reorganization cases; and (c) cases where the Commission has approved security issues conditionally.

(a) *The Stock Dividend Cases.*

In seven cases the Commission has been called upon to approve the issue of securities for the purpose of paying stock dividends. It has approved the capitalization of the surplus in this manner only to the extent that such surplus consists of items falling within the Commission's definition of "capitalizable assets." This test is described in general terms:

> "We should authorize the capitalization of those assets of the carrier only which have been provided and which are intended for continuing productive use in the service of transportation."

This test apparently rests on a construction of that part of the new Act which requires the Commission to find that the security issue relates to "the proper performance by the carrier of *service to the public as a common carrier.*"

"Capitalizable assets," thus defined, do not include "flexible assets," these comprising "current, liquid, quick, working or floating assets." Thus United States Government bonds and certificates of indebtedness, net balances due from the United States Railroad Administration, securities of non-affiliated companies, or of affiliated companies not controlled by the applicant, are said to fall within this category on the ground that "if it should be thought desirable to distribute the portion of surplus invested in such securities among the stock-holders, the applicants would be able to apportion the securities themselves or distribute the proceeds thereof." It is also said that such investments are "neither property used or useful in rendering public service, nor an assured part of such surplus."

The extreme to which this ruling of the Commission leads is shown in the case of a corporation of Hawaii, chartered as both a railroad and a land-development corporation. Not only was capitalization refused in respect to an appreciation in value of railroad property "in the absence of a realization of the appreciation by sale or otherwise," but the value of all land holdings not used for transportation purposes was excluded in determining the amount of surplus which could be capitalized. The Commission

has also required that "a substantial surplus should remain uncapitalized as a support for the applicant's credit, providing for emergency needs, offsetting obsolescence and necessary investments in nonrevenue-producing property, and serving as a general financial balance-wheel."

Capitalization of surplus through the medium of stock dividends has been permitted as to investments in additions and betterments, equipment and rolling stock, stock ownership in leased lines "of which the applicant is the virtual owner," materials in private sidings, non-carrier land acquired for railroad purposes "portions of which are in partial use and all of which it intends ultimately to use," and a "reasonable amount of working capital, including therein a sum sufficient to enable it to carry an adequate stock of materials and supplies." Advances to leased lines may be capitalized "when shown on the applicant's books as investments," but capitalization of similar advances to affiliated companies has been denied. "In order to encourage their construction and use," capitalization of stock holdings in union depots and terminal companies is permitted without regard to the "virtual control" required in respect to leased lines, but the condition is imposed that such stock shall not thereafter be sold or pledged without the consent of the Commission. Stock in non-affiliated express companies is not permitted to be capitalized because the applicant "may, at any time, dispose of its holdings."

The finding that capitalization of stock-holdings in union stations and terminal companies will "encourage their construction and use," is an adoption of one of the reasons urged by the applicant companies in favor of stock dividends as a means of encouraging investment in railroad securities. The other tests applied are particularly important if they are to be taken as representing the Commission's view toward railway security issues in general. The requirement that "necessary investments in nonrevenue-producing property" be uncapitalized, and that capitalization should only be permitted in respect to assets "intended for continuing *productive use* in the service of transportation," may well be rejected by the courts, for a railroad corporation should be permitted to earn a return upon all property "necessary" to its public service, and to capitalize it without regard to its revenue-producing qualities.

The declination to permit capitalization of stock ownership in leased lines which are not "virtually owned," on the ground that

such ownership is unnecessary because the lines could be operated under the lease without regard to stock ownership, constitutes a substitution of present administrative judgment for past managerial discretion, at least to the extent that the stock ownership in the leased line may have been an integral part of the lease itself. The theory that investments in non-affiliated companies or in Government bonds are "neither property used or useful in rendering a public service, nor an assured part of such surplus," overlooks the fact that such surplus at least tends to strengthen the credit of the railroad company and to aid it in building up a system of adequate transportation. It is also difficult to follow the line of reasoning which permits the capitalization of surplus represented by stock ownership in affiliated corporations where *all* of the subsidiary's stock is thus owned, while refusing permission to capitalize such holdings where a part of such stock is outstanding in other hands. Likewise the difference in principle, which allows the capitalization of surplus represented by "advances" to leased lines, while refusing to permit capitalization of such surplus as is invested in the securities of the same lines, is not well defined. The theory on which the capitalization of stocks and bonds in other companies, both affiliated and non-affiliated, is denied, *i. e.*, on the ground that these securities or their proceeds may be distributed among the stock-holders, is not in accordance with the statement of the Supreme Court of the United States to the effect that after transfer from surplus to capital, the surplus is no longer available for actual distribution.

Nevertheless, these are the tests which the Commission has adopted in administering the statute, and they represent the Commission's conclusions as to its discretionary power in determining what security issues are "compatible with the public interest," and "necessary and appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier." There seems little likelihood that the regulation of security issues through the Commission will be held to be an unlawful delegation of legislative power in the light of the fact that the Supreme Court of the United States has three times referred to this control of securities as an integral part of the Transportation Act, 1920. On the other hand, differentiations which are not warranted by the statute itself will undoubtedly be set aside by the courts, for it does not appear that Congress intended, even if it could have done so, to give the Commission

general authority to substitute its own discretion for that of the railroad executives. It was for Congress and not for the Commission or the courts to determine the essential ingredients of "public policy." The "public interest" which the Commission must determine will doubtless be held to be that public interest which Congress may be said to have defined in the Interstate Commerce Act read as a whole.

The denial by the Commission of a right to issue securities, or to capitalize surplus, need not under the present law directly affect the right of a railroad corporation to earnings. Under the law the return which the corporation is permitted to earn before "recapture" is based on the value of its property "held for and used by it in the service of transportation," and not upon capitalization. Only where consolidations are authorized by the Commission under Section 5 of the Interstate Commerce Act is it required that the bonds and stocks at par of the consolidated company shall not exceed the value of the consolidated property as determined by the Commission. Until such consolidations are authorized, there is no essential relationship under the Act between capitalization and the sort of value which the Commission is directed to determine under the Valuation Act. That value, however, seems to be the background from which the Commission is gauging the propriety of security issues at present, and its exclusion from capitalization of such items as non-carrier lands, appreciated value of railroad property, and investments in other companies and in Government bonds, is significant.

(b) *The Reorganization Cases.*

Approval of reorganization plans after receiverships is a matter for a court having jurisdiction of the subject-matter. But under the amendments to the Interstate Commerce Act, authority from the Interstate Commerce Commission for the issuance of new securities is necessary. In the first of such applications made under the new law the Commission approved the security issue upon an apparently incomplete record "in view of the manifest desirability of ending a long receivership," coupled with evidence "that the new capitalization will not be disproportionate to the earning power of the applicant." Similar authority has been granted in other cases, but the Commission has declined to define general principles or establish definite rules in respect thereto.[1] In grant-

[1] "It is suggested that our policy with respect to reorganizations ought to be somewhat more clearly defined. We have had only a few such cases to deal with,

ing such authority the Commission has not hesitated to impose conditions such as a provision that the applicant shall not underwrite proposed dividends upon stock in a fuel company held by one of the constituent carriers in the reorganization, and that proposed compensation to the reorganizing managers and their counsel is to be determined subject to the approval of the Commission. In passing upon such applications the Commission has held that a certificate of public convenience and necessity in respect to the acquisition of a line of railroad within the purview of Section 1, paragraph 18, of the Act, is not required where the property was in existence and operated in interstate commerce prior to the effective date of that paragraph, nor is such a reorganization necessarily consolidation within the purview of Section 5, paragraph 6. But where authority is sought for acquisition within the scope of Section 5, paragraph 2, the Commission has granted it.

(c) *Conditional Approval of Security Issues.*

The new Act authorizes the Commission to grant or deny an application to issue securities in whole or in part, "or to grant it with such modification and upon such terms and conditions as the Commission may deem necessary or appropriate in the premises." In the approving of a joint bond issue of the Northern Pacific and Great Northern to re-finance at maturity the bonds issued in 1901, secured by a pledge of Burlington stock, two Commissioners dissented on the ground that the refunding issue should be at a lower interest rate and a shorter maturity. A subsequent application by the Northern Pacific to retire a portion of these refunding bonds by its own issue, was approved with a statement of administrative policy by the Commission:

"It may be that, at some future time, such retirement could be effected on more favorable terms and with greater interest savings. But corporate policy, in a case of this kind must be determined by the carriers' directors. And, since the responsibility for the determination rests with them we do not feel that the substitution of our judgment for theirs would be warranted."

and these have come before us as individual cases in a continuous procession of pressing matters, all of which are rather new to us, to be administered under a new law. In the few cases referred to, the difference between the methods of reorganization have been so substantial as to suggest the inadvisability of attempting at this time to define a general policy with respect to reorganizations. It is probable that in the future, as in the past, each case of reorganization will have to be considered and disposed of on its own merits and in the light of its own conditions. However, just as soon as our experience with concrete cases may warrant it, we shall be prepared to establish any general principle which the concrete facts may justify." 76 I. C. C. 106 (1922).

The Commission has, however, approved the bond issue of a small company which it was sought to sell at not less than 80 per cent of par, upon the condition that it should be sold to net the applicant not less than 90 per cent of par, and has granted an application for authority to pledge bonds as security for notes subject to a ratio based on the prevailing market price of the bonds rather than on par value as proposed by the applicant. It has also approved a bond issue upon condition that the proceeds be held in a separate account and expended solely for capital purposes and not pledged or sold to restore income. In approving security issues by a lessor company to be delivered to the lessee company in settlement for expenditures for additions and betterments, and on which the lessee assumed a contract dividend obligation, the Commission has imposed the condition that the securities shall not thereafter be sold or pledged by the lessee without further consent of the Commission. This is justified on the ground that so long as the lessee holds the securities "in its own treasury, the issue of such stock has only bookkeeping importance," while the sale by the lessee "would be equivalent in practical effect to the issue of its own interest-bearing securities. . . .

It is to be observed that while this power to impose conditions upon security approvals, if carried to an extreme, would virtually substitute the discretion of the Commissioners for that of the corporate directors, it has thus far been exercised sparingly and with the apparent desire to leave the responsibility for the financial structure of the corporation upon the corporate officers. Only where the Commission has believed that a clear case of public injury would result, has it resorted to the power to grant conditional approvals. . . .

2. Stock Dividends [1]

By the Commission:

The Chicago, Burlington & Quincy Railroad Company, a common carrier by railroad engaged in interstate commerce, seeks approval under section 20a of the interstate commerce act of its first and refunding mortgage and authority to issue $60,000,000 par amount of capital stock and $109,000,000 of first and refunding mortgage bonds. The application was made under oath, signed,

[1] *Chicago, Burlington and Quincy Stock Dividend Case*, 67 I. C. C. 156 (February 28, 1921). See Jones, pp. 590–592, and Vanderblue and Burgess, pp. 328–329 n.

and filed on behalf of applicant by one of its executive officers, and notice thereof was given to and a copy thereof filed with, the governor of each state in which applicant operates. No objection to the granting of the application was made directly by any state authority other than the Nebraska State Railway Commission. Hearings were had and the Northern Pacific Railway and Great Northern Railway appeared in support of the application.

The applicant owns 8,948 miles and operates 9,372 miles of steam railroad, extending from Chicago, Ill., southwesterly to St. Louis and Kansas City, Mo., Omaha, Nebr., and Denver, Colo., and northwesterly to St. Paul and Minneapolis, Minn., and Billings, Mont., with a line connecting Billings and Denver, another from Chicago to the southern Illinois coal fields, and numerous other branches and feeders. It has extensive and valuable terminals in Chicago, St. Louis, Kansas City, Omaha, Denver, and St. Paul, expensive bridges over the Mississippi, Missouri, and Platte rivers, modern buildings and equipment, and a large and well-established interchange of traffic with its connections. It operates in 11 states and serves a prosperous and well-developed territory.

The applicant is an Illinois corporation and the railroads incorporated in other states which it now operates have been conveyed to it in fee simple. In 1901 the Great Northern Railway and the Northern Pacific Railway jointly acquired control of applicant's system by the purchase of $108,000,000, or 96.79 per cent, of its capital stock, giving in payment therefor their joint 4 per cent bonds maturing in 1921 and pledging the stock acquired as collateral security.

The applicant has outstanding $110,839,100 of capital stock and $174,040,800 of bonds, of which latter $168,050,000 is in the hands of the public. The greater part of its funded debt is issued under three mortgages.

The applicant's Nebraska extension mortgage is a lien upon 269.16 miles of road, and is secured by deposit of $23,494,000 of first-mortgage bonds on 1,201.84 additional miles of subsidiary companies which have conveyed their roads to the applicant. There have been issued thereunder to reimburse the treasury for expenditures for extensions of lines $29,441,000 of 4 per cent bonds maturing in 1927, sold at prices ranging from 84.5 to 95.12, netting $26,843,383.40. Discounts thereon of $2,597,616.60 were charged to construction. Of these bonds, $20,024,000 are out-

standing, $18,294,000 in the hands of the public, and $1,730,000 in the applicant's treasury.

The applicant's Illinois division mortgage covers 1,646.4 miles of road. There have been issued thereunder $85,000,000 in bonds maturing in 1949, $56,000,000 to be used to retire prior bond issues, the remainder to reimburse the treasury, $15,000,000 being for expenditures for construction and acquisition of roads before July 1, 1899, and $14,000,000 being for additions and betterments subsequent to that date. Some $50,835,000 of these bonds bearing interest at 3.5 per cent were sold at prices ranging from 75 to 103.5, netting $45,992,235. Discounts thereon of $1,088,975 were charged to construction and of $3,753,790 to profit and loss. Some $34,165,000 of 4 per cent bonds were sold at from 98.5 to 104.5, netting $35,228,505. Discounts thereon of $9,880 were charged to construction and $1,073,385 of premiums were credited to profit and loss. Of the 3.5 per cent bonds, $384,000, and of the 4 per cent, $189,000, are in the applicant's treasury. The remaining bonds of both issues are in the hands of the public.

A general mortgage maturing in 1958 covers substantially all of applicant's railway property existing in 1908, being a first lien on more than 5,000 miles of road. It is so limited that not over $300,000,000 can be outstanding thereunder at any one time, and that bonds can not bear over 5 per cent interest. There have been issued thereunder and are outstanding $65,247,000 of 4 per cent bonds which were sold at from 91.5 to 100, netting $62,444,450. Discounts thereon of $2,602,550 are being amortized from income during the life of the bonds. Before the passage of the transportation act, 1920, the Public Utilities Commission of Illinois authorized the issue of $121,378,000 of general-mortgage 4 per cent bonds. On this amount $2,252,000 have been issued, leaving $119,126,000 unissued, of which $9,873,000 are in the applicant's treasury and $109,253,000 remain unexecuted.

The applicant's investment in road and equipment as shown in its accounts is $503,745,837.57. Its outstanding securities amount to $284,879,900, leaving a book surplus of $218,865,937. The applicant contends that it has an actual surplus materially in excess of that figure which does not take into account investments in property other than road and equipment, and does not include any sum in consideration of its guaranty under section 209 of the transportation act, 1920. It asserts that the value of its physical property upon the basis provided in section 19a of the

interstate commerce act amounts to $572,800,000, or about $70,000,000 more than the total shown as investment in road and equipment. Depreciation on its equipment has been charged to the amount of $48,514,239.62. The applicant states that since July 1, 1901, it has invested out of earnings $189,070,776.12 in additions and betterments to its property, only a small portion of which was expended for nonrevenue-producing assets; that it has in addition used earnings to retire bonds expending $191,348,478.49, properly chargeable to its capital account, no part of which has been capitalized. During that time the applicant has increased its mileage from 7,600 to 8,900 miles. The total mileage owned and operated has increased from 7,700 to 9,300 miles. Second track has been increased from 425 to 1,000 miles and yard track and sidings from 1,700 to 3,200 miles. The tons of traffic handled have increased from 17,000,000 to 49,000,000; the ton-miles from 3,800,000,000 to 14,000,000,000; the density ton-miles per mile of line from 582,000 to 1,483,000; the trainload from 200.43 to 722.19 tons; the carload from 12.5 to 26.5 tons. The applicant has during this time reduced its funded debt and now has securities in the hands of the public totaling only $31,164 per mile of road.

Objectors do not deny the existence of property value used and useful in rendering the public service materially in excess of the applicant's present capitalization, and do not question the nature of the expenditures involved. They question the right of a public service corporation to declare dividends from invested surplus acquired from earnings during a period when the stockholders were receiving regularly a fair dividend upon the outstanding capital.

The applicant's net income applicable to dividends for the past 10.5 years has been as follows:

Period	*Amount*	*Period*	*Amount*
Year ending 1910......	$13,308,746.18	Year ending 1917......	$28,009,001.57
Year ending 1911......	16,843,762.73	Year ending 1918......	15,947,881.56
Year ending 1912......	14,106,753.78	Year ending 1919......	16,561,229.51
Year ending 1913......	19,430,745.89		
Year ending 1914......	17,114,407.14	Total for 10.5 yrs.	202,490,286.25
Year ending 1915......	17,288,912.63		
18 months ending 1916 [1]	43,878,845.26	Average per year....	19,284,789.17

Notwithstanding this large net income available for distribution among the stockholders, the average of all dividends paid from

[1] 18-months period due to change in report year.

1901 to 1920 was 8.51 per cent upon the abnormally low capitalization and 3.916 per cent upon the average property investment in excess of all outstanding bonds.

There is no proof that this income is the result of excessive rates. Traffic has been carried by the applicant at rates controlled by state or interstate regulatory bodies, substantially the same as those applicable over competing lines. Nor is there any proof that the total return upon the fair value of the applicant's property has been excessive. Its right to capitalize $119,000,000 of the surplus has, in fact, been recognized by the Public Utilities Commission of Illinois, the state of its incorporation, under express statutory provision. A five-year statutory limitation prevented that body from considering surplus accumulated during an earlier period.

The applicant points out that its present financial structure is inadequate for present and future needs. Its Nebraska extension and Illinois division mortgages are closed, and its general mortgage so limited that its use is impracticable under present conditions. The execution of a new mortgage subject to these existing liens would be futile. It now proposes to close the general mortgage without issuing further bonds under it, and to execute a 50-year first and refunding mortgage to secure coupon bonds to be issued in series at interest rates, and redeemable at times and on terms to be determined by the directors at the date of issuance, subject to our approval.

Under the general mortgage, $175,000,000 of bonds were reserved to refund $168,501,000 of prior-lien bonds at premiums not exceeding $6,499,000; and bonds were issuable thereunder as follows: $2,000,000 to finance such refunding, $45,000,000 to reimburse for expenditures before 1908, and the remainder for future additions and betterments. It is stated that only $78,000,000 could be issued for the last-mentioned purpose. But there is evidence that only $139,744,000 of such bonds are now reserved for refunding purposes, and the amount necessary therefor would seem to be even less. Of the original $169,501,000 of prior-lien bonds, $46,728,000 have matured and presumably been retired, leaving $121,773,000, of which there is reason to believe $12,268,000 have been retired. If so, the only remaining prior liens are the Nebraska extension and Illinois division mortgages, to refund which at maturity, par for par, only $102,800,000 would be needed. But the aggregate amount of bonds now outstanding under those mortgages is $105,024,000. Therefore, if all prior-lien

bonds have been, or shall be, refunded at par without expense to the applicant, $129,729,000 of bonds would be issuable now under the general mortgage which, with the $65,247,000 outstanding and $105,024,000 reserved for refunding, would close said mortgage.

The applicant points out that bonds under its general mortgage could not bear more than 5 per cent interest, and if they could be marketed at all, would have to be sold at heavy discount, and that they would not be redeemable before 1958. It is shown that the amount of bonds issuable under that mortgage would not meet applicant's needs for additions and betterments at the current rate beyond 1933, and if the proposed dividend were paid would not meet requirements beyond 1929. It is contended that the proposed financial program would better the applicant's credit and strengthen its position.

Authority is sought to issue $109,000,000 of first and refunding mortgage bonds at 6 per cent, $29,000,000 thereof to be used for future additions and betterments subject to our approval and $80,000,000 thereof to be held free in the applicant's treasury for any lawful use, including issuance as dividends. It appears that they would be used solely for dividend purposes and if authorized would be distributed among the stockholders.

Applicant calls attention to the necessity of refunding on July 1, 1921, $215,227,000 of its controlling roads' joint 4 per cent bonds given in payment for its stock, and points out that practically all of its proposed bond issue if authorized would be available to those roads for use in meeting that obligation, thus materially reducing their fixed charges. It points out that as the controlling roads are its principal stockholders it is their foregoing of dividends which has produced its invested surplus. It contends that its own increase in fixed charges would be offset by the material advantage resulting to its established connections. It shows that the proposed financing would slightly reduce its ratio of bonds to stock, placing it substantially upon the basis of 1.5 to 1, and would not so increase fixed charges as to impair the applicant's ability to serve the public.

Objectors contend that the applicant should not be permitted to increase its fixed charges without a showing of resulting benefit to applicant. The issuance of the proposed bonds at this time would materially increase the interest burden without apparent necessity. The interest rate at the time of the above-mentioned

expenditures from surplus was not in excess of 4 per cent. Authorization of bonds at that rate at the present time would seem inexpedient. Division of that part of the surplus not needed for ordinary surplus purposes by means of stock appears more in accord with the welfare of the applicant and the public.

Both the wisdom and legality of the joint acquisition and ownership of the Burlington by the Great Northern and the Northern Pacific are questions foreign to this proceeding and therefore require no consideration on this occasion.

While we do not minimize the advantages derived by the applicant from its connections with the northern lines, we are not convinced that the continuance of those connections is dependent upon the issuance of the proposed bond dividend. The general advantages of minimizing fixed charges in refunding the joint 4s are apparent, but we can not share applicant's apprehensions relative thereto. The northern lines enjoy a position relatively favorable to financing such a refunding. The value back of the applicant's stock renders it desirable collateral security. No evidence has been introduced which convinces us that the refunding could not be accomplished at a reasonable rate by the issuance of bonds of the Great Northern and Northern Pacific secured by mortgage and the pledge of the applicant's stock.

Confusion has been injected into this case by the failure to distinguish between the issuance of bonds to reimburse the treasury from the proceeds thereof for expenditures for additions and betterments and the issuance of bonds from invested surplus for dividend purposes. We cannot accept the applicant's argument which finds in the Illinois commission's approval of the issuance of 4 per cent or 5 per cent bonds to reimburse applicant's treasury for expenditures for additions and betterments, a sanction of a dividend of 6 per cent bonds. It is true that body's authorizations contained no express prohibitions against such a dividend, but each of its orders provided that the bonds should be sold and a majority of the orders specified sale for cash; all required that the proceeds be applied to specified purposes. One order made optional the pledge of the bonds. The Illinois statute enumerated the purposes for which a public service company might issue securities without including the issuance of dividends, and expressly stated that securities might be issued for no other purposes. Nor is it certain that the question before the Illinois commission was wholly analogous to that here presented, for the approval of a bond issue during a

normal period differs materially from approval of an issue at an abnormal rate at an abnormal time, when the only material advantage anticipated inures to parties other than the applicant.

The applicant seeks authority to issue $60,000,000 additional capital stock as a necessary basis for the proposed mortgage, under which the aggregate amount of such bonds can not exceed three times the outstanding capital stock. It is proposed to issue such stock as a dividend.

If the applicant's petition is granted in full it is urged that there will remain a corporate surplus of $101,781,197; that this amount would be adequate to meet the applicant's emergency needs, support its borrowing power, afford insurance against obsolescence, minimize short-term financing, and serve as a general financial balance wheel. Allowance should be made, however, pending the valuation of the applicant's system, for shrinkage of book values, so that the adjusted capitalization will not leave an inadequate actual surplus.

The evidence establishes (1) that the Chicago, Burlington & Quincy Railroad has a great uncapitalized surplus; (2) that the present capitalization is far below the actual investment or any fair value for rate-making purposes which we may subsequently fix under the valuation act, section 19a of the interstate commerce act; (3) that the increase in capitalization which would follow the grant of this authority would still leave the total capitalization of the Burlington below the actual investment of the probably fair value of the property devoted to the public service; (4) that the remaining uncapitalized surplus would be sufficient to serve the purposes for which a surplus should be accumulated; and (5) that the present financial structure of the Burlington is obsolete and inadequate and that a new form of mortgage and a larger stock base to meet the requirements of statutes governing investments by savings institutions in various states are necessary.

We find that the proposed issue of $60,000,000 capital stock by the Chicago, Burlington & Quincy Railroad Company as a dividend (*a*) is for a lawful object within its corporate purpose, and compatible with the public interest, which is necessary and appropriate for and consistent with the proper performance by it of service to the public as a common carrier, and which will not impair its ability to perform that service; and (*b*) is reasonably necessary and appropriate for such purpose; but that the applicant has not justified an authorization of the issuance as divi-

dends of mortgage bonds against its surplus and that authority therefor should be denied. If the applicant desires, we shall give consideration on the present record to an application to issue bonds for appropriate purposes other than dividends.

The question of a proper return on the fair value of property devoted to the public use is not pertinent. It is not before us. No one questions the right of owners to compensation for sacrifices made in foregoing dividends. The denial in this case extends only to the issuance of a bond dividend by a railroad which has no need for the bonds, and which can advantageously issue all the stock reasonably required for its needs. The more adaptable form of mortgage which the applicant desires can be provided without the issuance of a bond dividend.

An appropriate order will be entered.

Clark, *Chairman*, concurring:

I concur fully in the approval of the issuance of $60,000,000 of capital stock. I do not find myself in accord with the refusal to authorize $80,000,000 of bonds. I regard the case as unique, and, therefore, as one that should not be decided upon the idea that it establishes a general precedent or a general policy. The Burlington has an abnormally low capitalization and an abnormal surplus from income that has been spent upon the property. That surplus has been accumulated under rates fixed by state and federal regulating bodies. Competing carriers, under the same rates, have not accumulated similar surpluses. The Northern Pacific and the Great Northern own 97 per cent of the stock of the Burlington, and have so owned it for some 20 years. They must refund their obligations, assumed in acquiring that stock.

Looking at the situation in its general aspects, and from the standpoint fixed in the present law of considering and dealing with the railroads in a national sense or in large groups, it would seem that the main question is what will be the effect upon the public interest. The northern lines must pay these joint collateral bonds or make good any deficit from surrender of the collateral. Forfeit of that collateral would, as it seems to me, cause the placing upon these lines of an additional burden as a net loss, to be borne by the public. Obviously these owning lines will not choose that course. The debt, which I regard as well secured, must be met. Is it more to the public interest that it shall be done by retaining this $80,000,000 in the Burlington's surplus, which

admittedly will be large enough for all reasonable purposes if the $80,000,000 is disbursed, and adding a like sum to the capitalization of the owning lines, with substantially larger fixed charges, than to consider the three systems as a family and permit the owning lines to have the benefit of that much of the surplus of the Burlington which is not needed by it? The total bonded indebtedness of the three systems would not be substantially different in either event. It seems certain that under any plan that is left open for refunding this debt the fixed charges will be much greater for a long term of years than they would be if the $80,000,000 of bonds were made available for the sole purpose of reducing the principal amount of the debt about to become due.

McChord, *Commissioner*, concurring:

Agreeing fully with the majority report, I wish to state briefly certain other considerations which lend support to my concurrence in the conclusions reached.

This is not a matter of securing needed new and additional capital for the Burlington, but an undertaking to distribute as dividends its accumulated surplus, principally represented in its augmented corporate property, partly in the form of additional capital stock and partly in interest-bearing securities. While one avowed purpose is to afford the applicant a larger and more flexible credit basis, admittedly the principal beneficiaries would be the two majority stockholders, whose maturing bonds must soon be retired by issues of new securities. When all is said and done, the submitted justification for the course proposed is that, as against an available interest rate of 6 per cent for Burlington bonds, funds obtained by the Great Northern and Northern Pacific upon their own securities probably would cost them 8 per cent. This purely speculative apprehension does not justify itself to my mind. The now outstanding bonds of those lines are in a large measure collaterally secured by capital stock of the Burlington, and the credit of that company would equally become the foundation of an issue of its own bonds or of refunding issues of the Great Northern and Northern Pacific collaterally secured by an equivalent dividend issue of Burlington capital stock. Indeed, the total pledged security would be ampler, in the ratio of the accumulated surplus, than that by which the now maturing bonds were originally supported. Incidentally, the fact, disclosed by the annual reports, that for the years 1918 and 1919,

as against the 8 per cent dividends of the Burlington, the Great Northern and Northern Pacific declared dividends of 7 per cent on larger stock bases at least strongly suggests that the credit of the latter two lines is not so low as to justify an exaction from them of an interest rate in excess of that available on the Burlington's own securities, particularly when the collateral security they would have to offer is considered.

It does not appear that the two lines most concerned, as they might and should have done, have laid before the interests from whom the requisite financial assistance is to be obtained the merits of refunding issues of bonds of those lines and the enhanced value of the securities they would have to offer. If when this were done the financial interests were nevertheless to take advantage of the necessities of those carriers and demand a prohibitive rate of interest, which is hard to believe, these interests must bear their share of the responsibility for the impairment of the carrier's transportation functions. The present transportation and industrial situation calls for moderation and forbearance, and there can be no condoning an abuse of opportunity which can only tend to block a downward trend of prices so essential to the mutual welfare of carriers and shippers.

The assertion that if this application be denied the outstanding 4 per cent bonds can not be refunded at less than 8 per cent is startling. If the financial institutions of the country have determined to increase the interest rate on such bonds 100 per cent, and it is accomplished, our railroads can not weather the storm. Good business judgment on the part of the Great Northern and Northern Pacific would dictate the submission to the present bondholders of an offer of 6 per cent refunding bonds, representing an increase of 50 per cent in earning power and resting upon a materially enlarged basis of security.

An approval of the proposed application and the devotion of approximately 98 per cent of the proposed bond issue to the retirement of the maturing Great Northern and Northern Pacific bonds would virtually weld into one inseparable system, for the life of the bonds the three trunk lines, although it is by no means certain at this time that such a merger would suit the purposes of amended section 5 of the act. For other reasons, we should proceed with particular care in these financial matters, especially in these critical times and until the trend of events is definitely determined. At least until a financial and industrial equilibrium

is reached, and perhaps, in any event, the burden of the additional fixed charges to result from a bond issue should rest directly upon the carrier or carriers for whose substantial benefit the issue is made.

POTTER, *Commissioner*, concurring:

I concur in that part of the majority report which authorized the issuance of $60,000,000 of stock but do not concur in the view that permission to issue $80,000,000 of bonds should be denied. The withholding of permission to issue the bonds under the circumstances as they are presented, is to my mind, hostile to the public interest.

The issuance of bonds to reimburse the treasury of a carrier and replace income used for additions and betterments not only is lawful, but has the sanction of established practice and general public and official approval. When carriers have in their income account surplus funds not needed, they have the right to distribute that surplus among their stockholders, and the control of such distribution is not within our jurisdiction. The question presented by the situation before us is whether the issuance of bonds to reimburse the treasury is proper, coupled as it is with the proposed distribution among the shareholders of the restored income. The importance which existing conditions attach to this question is obvious. It is not a good time to issue securities carrying the present high interest rates. If, however, securities must be issued, they should be issued so as to take advantage of the lowest available rate. A basis that is high is preferable to another basis that is still higher. The real question which is involved in the existing situation is whether permission to put out securities on one basis should be denied when because of that denial we will have to authorize the issue of securities on another and higher interest basis.

The investing public now holds the bonds of the northern companies maturing July 1, 1921, in the aggregate amount of $215,000,000. The record made upon the public hearing before us when all interests were represented supports the conclusion that the plan proposed will accomplish a reduction of the interest burden upon the three properties considered together, substantially below the best basis available under any other plan. The northern companies as Burlington stockholders naturally consent to the proposed bond issue and distribution. It does not appear that the minority of

Burlington stockholders in any way will be injured thereby. We are to consider the question of public interest. Courts applying the law will attend to any question as to relative rights of shareholders. The comparatively favorable interest basis which the proposed plan affords serves the public interest in an important way. By reducing the aggregate interest burden of the three companies, their net income will be increased, the drains upon their earnings will be reduced, their aggregate strength and credit will be improved, and they will be enabled better to serve the public. A plan which facilitates the lowering of the basis upon which a large financial undertaking is handled should naturally have a tendency to improve the general credit situation in which carriers and shippers have a vital interest. This consideration will apply particularly to the carriers in the northwestern group.

We should deal with the substance of things. The ownership of approximately 97 per cent of the Burlington stock by the northern companies justifies treating the Burlington company as an instrumentality through which its properties are owned by the northern companies—if this may be done in justice to the minority of Burlington stockholders, and it may for the purposes of this application be so treated in justice to them. The stockholders of the northern companies are the persons vitally interested in the situation before us. They own practically all of the assets of the Burlington company in the same way they own the assets of the northern companies. They must finance $215,000,000 on July 1. It is natural and right for them to feel that if they can make a saving by using their Burlington security in part instead of relying entirely upon the property of their northern companies they should be permitted to do so, when to do so is, as in this case, consistent with the public interest and the interest of the Burlington minority shareholders.

DANIELS, *Commissioner*, dissenting:

The chief objection to the majority report goes not to what the report grants, but to the far more vital permission which it withholds. It concedes the propriety of capitalizing surplus to the amount of $60,000,000 in stock, the effect of which is remote, while it denies the propriety of capitalizing surplus to the amount of $80,000,000 in bonds the beneficial effect of which would be immediate. It allows a stock dividend which will be available as a stock base for bond issues in future and denies a bond issue which

will effect substantial economies in refunding at present. It provides for the future financing of the Burlington, while it disallows the means proposed for financing the current and pressing exigencies of the Burlington's proprietors. The permission granted therefore seems to me to be largely ineffectual.

The majority report evidently attaches no conclusive weight to the objection most seriously urged before us against the proposed capitalization of the Burlington's surplus—that a public-service corporation has no right to declare dividends from invested surplus acquired from earnings during a period when the stockholders were receiving regularly a fair dividend upon the outstanding capital stock. It properly points out that "the average of all dividends paid from 1901 to 1920 was 8.5 per cent upon the abnormally low capitalization and 3.916 per cent upon the average property investment in excess of bonds." It declares correctly that "there is no proof that this income is the result of excessive rates." It calls attention to the fact that "applicant's right to capitalize $129,000,000 of surplus has in fact been recognized by the Public Utilities Commission of Illinois, the state of its incorporation," all of which, it may be added, was in the form of bonds, not stock.

The majority report therefore affirms the lawfulness of this stock dividend as against uncapitalized surplus derived from earnings under reasonable rates and reinvested in property permanently devoted to the service of the public. The proposed dividend against the surplus, if the dividend took the form of bonds, is not denied by the majority report on the ground that such a dividend would not be for some lawful object within the applicant's corporate purposes, or otherwise in conformity to the requirements of paragraph (2) of section 20a of the interstate commerce act. The denial is mainly based on the finding that "the applicant should not be permitted to increase its fixed charges without a showing of resulting benefit to applicant." The report expressly says:

> No one questions the right of owners to compensation for sacrifices made in foregoing dividends. The denial in this case extends only to the issuance of a bond dividend by a railroad which has no need for bonds.

To test this position, one may ask, why should applicant be permitted to increase the stock base, on which additional dividends may be anticipated, without a showing of resulting benefit to applicant? And why should the denial not extend to the issuance

of a stock dividend to a railroad which has no need for more stock?

The answer suggested by the majority report is that the applicant has a need for more stock in order that it may have a larger stock base, and in order that it may execute a new mortgage under which the permissible bond issues may be greater than those expedient under its present general mortgage. That this is technically true may be at once conceded. But the differentiation made between the additional stock which the applicant is found to need and the additional bonds for which the railroad is found to have no need rests on the rather tenuous ground that future financing will be promoted by an increase in stock. The total stock as increased, it may be observed, will carry no greater equity than the existing stock and will be worth intrinsically no more as collateral. If this distinction is the only valid distinction between the two parts of the application, what justification can be found for a proposal to capitalize surplus derived from earnings and invested in the property when there is no intention of executing a new mortgage requiring an enlarged stock base, or of executing any mortgage at all? No one may question the right of owners to compensation for sacrifices made in foregoing dividends, as the majority report affirms, but it would appear that the finding of the need of the railroad for more stock which will cast an increased dividend charge on the carrier and the simultaneous finding of no need for more bonds carrying additional fixed charges is rested on an essentially technical or formal basis.

The essential error, as it appears to me, in the reasoning of the majority report is centered in its too exclusive consideration of the Burlington as a separate and distinct legal entity, and in a disregard of the essential factors in the case. Railroad corporations after all are but legal instrumentalities by which individuals effect their ends. To disregard the individual shippers served and the individual investors involved, to say nothing of the general status of railroad credit, by confining attention to the legal entity known as the Burlington is to miss the significance of the whole situation. The two northern carriers, the Northern Pacific and the Great Northern, own substantially 98 per cent of the stock of the Burlington. "Both the wisdom and legality of the joint acquisition * * * are questions foreign to this proceeding." Since they acquired their ownership they have permitted a large part of the Burlington's earnings to be reinvested in extensions, additions, and betterments. In consideration thereof they are to obtain a stock dividend

of approximately $60,000,000. But these northern carriers in their acquisition of the Burlington stock executed joint obligations of approximately $215,000,000 which fall due on July 1, 1921. The refinancing of an amount as great as this is unparalleled in the history of railroads and is to be undertaken at a time when the ordinary run of investments is carrying unusually high rates of interest. The plan which these northern companies propose is to discharge a part of this huge obligation by obtaining $80,000,000 in bonds of the Burlington of which they are the proprietors, and by applying the proceeds thereof to that end. The residue of the indebtedness they propose to finance jointly or severally by the issuance of their own obligations. In essence, their plan, matured after months of study, is to redistribute the $215,000,000 of indebtedness, so that a part thereof will be secured by the bonds of the strongest member of the trio. If the proposal were to saddle a part of the debt upon a carrier only distantly related to the two northern companies and in which they had not for 20 years past reinvested the greater part of its earnings to which they were currently entitled in dividends, the plan would merit instant disapproval. But in thus proposing to mortgage the Burlington they are mortgaging property built up out of earnings to which as proprietors they might during the past 20 years have asserted and enforced their claim. In reality, therefore, the proposal is akin to one which proposes in discharge of indebtedness, to pledge as part security that which, by reason of their equity therein, is their most available asset. It is testified that this plan of refunding will save annually in fixed charges an amount computed to be not less than $688,000, and which may be as great as $3,529,000. The exact annual saving depends on the interest rate necessary if the two northern carriers alone issue bonds for refunding. This annual saving in fixed charges is the essence of the matter. In the aggregate, the saving spread over the life of the bonds proposed to be issued will be of the greatest magnitude.

To deny the proposed issue of Burlington bonds in the belief that the refunding can be accomplished at an undefined but reasonable rate of interest by the issuance of mortgage bonds by the two northern companies alone, secured by the pledge of the Burlington's stock, appears to me to be a radically unwise step. When the transportation act, 1920, prescribed a return to carriers uniform for all rate groups, and expressly emphasized "honest, efficient, and economical management," the rejection of a project which

would permit savings in fixed charges running into the millions is directly at variance with the expressed object of the statute. . . .

There are two further observations which seem pertinent. The first is that the approval sought of the pending application is based on the situation disclosed in this particular case, and would affect not at all the indefinite continuance of the joint ownership of the Burlington by the two northern lines or the question of future consolidations that may arise under section 5 of the interstate commerce act.

The second relates to the responsibility of certain financial interests and institutions for the rate of interest on whatever securities may issue to effect the refunding of the Burlington joint 4s. The rates of interest currently prevalent are fundamentally traceable to world-wide causes which can be affected only in a minor and largely inappreciable degree by the instrumentalities through which securities are currently marketed. Just as the rise in war prices was a universal outcome of the relative scarcity of commodities, so the prevalent high rates of interest are a result of the universal dearth of capital seeking investment as compared with the current demand therefor. The high interest rates, as has so often been pointed out, are rather the symptoms of the evil the industrial world confronts in the relative dearth of capital, rather than the essential evil itself. Holders of maturing obligations are offered a wide range of choice in investments carrying attractive rates of return. The instrumentalities which affect the marketing of securities have therefore to reckon with a situation not of their creation and which they can not materially affect.

EASTMAN, *Commissioner*, dissenting in part:

I concur in the result reached by the majority, except that I believe the stock dividend should also be denied.

The chief purpose of the stock and bond dividends sought is to meet the needs, not of applicant, but of its stockholders the Northern Pacific and the Great Northern. The most persuasive argument in favor is the saving in interest charges which might result. The joint 4s, which now total about $215,000,000, fall due on July 1, 1921. It is testified that if the attempt is made to refund them by the issue of bonds of the same kind, it may not be possible to do so on better than an 8 per cent basis. On the other hand, applicant can issue $80,000,000 of bonds on a 6 per cent basis, and if it is permitted to do this and turn over the proceeds, or the bonds

themselves, as dividends to the Northern Pacific and Great Northern, the amount so realized can be used to retire some of the maturing bonds and the remainder can be refunded by the issue of mortgage bonds of the northern lines, with the net result that something like $3,500,000 in interest charges may be saved. This saving is apparently figured by comparison with the issue at 8 per cent of collateral-trust bonds like those maturing, and not by comparison with the issue of mortgage bonds of the northern lines for the total amount.

But is the reasoning sound? The transaction contemplated is not the flotation of new securities for the purpose of obtaining cash, but a refunding operation. In 1901 the holders of Burlington stock sold it at the excellent price of $200 per share, and 4 per cent interest has since been paid upon that amount, equivalent to $8 per share on the stock. If, upon maturity, they should be offered, in place of the collateral-trust bonds, an equal amount of 6 per cent mortgage bonds (or bonds secured in part by the stock and in part by mortgage) of the Northern Pacific and the Great Northern, this would be equivalent to $12 per share on the stock originally sold, or a return 50 per cent greater than has been paid for the past 20 years, combined with greater security. Would they reject such an offer and insist upon 8 per cent bonds, *doubling* the return, at a time when the railroads of the country are struggling desperately against a temporary tide of depression?

I have enough confidence in the investors of the country so that I do not believe that they would, if the situation were frankly explained and its bearing upon the general welfare of the country made clear. I realize the difficulty in attempting to control what appear to be current rates of interest. But this is a unique situation, and I am confident that investors will readily appreciate that under its special circumstances, and looking beyond the immediate present, they have more to gain than to lose from forbearance and moderation.

There is, moreover, a further alternative. Under the indenture securing the joint 4s, the holders of three-fourths in interest may agree, upon default, to accept applicant's stock in full satisfaction of their claims, and by such agreement they may bind the remaining one-fourth in interest. If this method of meeting the situation could be adopted, it would, it seems to me, be to the advantage of all concerned. For 20 years the northern lines have held control of the Burlington system, and the benefits have been admittedly

large. But the advantages of such control are no longer so important as they once were, in view of the wide powers over divisions, the routing of freight, and the use of terminal facilities conferred upon us by the transportation act, 1920. The return of applicant's stock to the holders of the joint 4s would place them in immediate possession of these very valuable shares; the chief argument for imposing upon applicant a new load of fixed charges would be gone; the credit of both the Northern Pacific and the Great Northern would be improved by the reduction in their own fixed charges; and the way would be left open for the consideration, without embarrassment, of the possible future union of the Burlington system with other railroad properties.

But the question before us is larger than one of mere interest rate. Applicant asks authority to issue $80,000,000 of mortgage bonds and $60,000,000 of stock, both issues to be used for dividend purposes. The bond dividend will be one of 72 per cent, and the stock one of 54 per cent. The total would fall short but $35,000,000, in par value, of the aggregate paid in dividends since 1901. The dividends prior to that year are not stated of record, but no claim is made that the return was inadequate. Since 1901 the dividend rate has averaged 8.5 per cent. The $140,000,000 of bonds and stock now sought for dividend purposes represents additional earnings which were turned back into the property. In other words, it is proposed to capitalize $140,000,000 of invested surplus. If all the excess earnings had been paid out in dividends from year to year, however, the aggregate of such dividends would not have equaled the present surplus, for it has grown in part from its own earnings.

Authority to issue these securities can not be claimed as of right. It is subject to our determination and we may grant authority only if we are able to make the statutory finding that the issue is "compatible with the public interest" and for an object "which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service."

Nor is it possible by denying the application to deprive applicant of any right. On this point there has been much confusion of thought. If the Burlington is lawfully entitled to 6 per cent or any other return upon the fair value of all its property, including invested surplus, nothing that we can do can take away this right;

and such return, if earned, can be paid regardless of the volume of securities outstanding. The real question, therefore, is whether it is "compatible with the public interest" to translate the invested surplus into shares of stock and mortgage bonds. I believe it is not, both because such translation may operate to enlarge rights of applicant as against the public and prejudice the consideration of a question which has an importance spreading far beyond the limits of this case, and because it will weaken applicant's splendid financial strength. To make clear the basis for this belief, let us consider the reasons advanced for surplus accumulations and their bearing on the public interest.

The carriers have again and again told us that sound policy demands that rates be high enough to permit not only the payment of reasonable dividends but the accumulation of large surplus reserves. Some have reduced this to the rule that for every dollar paid in dividends a dollar from earnings should be invested in the property. Financiers have been equally emphatic in favoring such a policy. Summarizing the arguments, we have been told that stockholders are interested quite as much in regularity and dependability of dividends as in their amount; that surplus reserves are necessary to maintain such regularity, and to protect against inevitable and wide fluctuations of earnings and financial disturbances; that they are needed for improvements which will not immediately yield revenue, or which will never do so but are required to enable a company to keep abreast of the times and furnish the best of services; and that they are equally necessary to enhance credit and enable financing upon favorable terms without disproportionate increases in funded debt. Before the Newlands committee in 1917 the carriers urged a need for earnings sufficient to pay regular dividends of 6 per cent with a surplus each year of 3 per cent besides. Stated in another way, it is claimed that to insure good credit surplus earnings should equal 25 per cent of the amount paid out in both dividends and interest.

I shall not stop to quote from the many expressions of opinion upon this subject with which our records are filled. I call attention, however, to the report of the Railroad Securities Commission transmitted to Congress with his approval by President Taft in 1911. This report favored the building up of surplus reserves, but disapproved and urged the prohibition of all "script, bond, and stock dividends."

With the representations of the carriers in favor of surplus

earnings have gone equally emphatic representations by shippers. They claim that when such earnings, over and above reasonable dividends, are invested in carrier property, the public, having provided the funds, has an interest in that property and can not fairly be asked to pay the same return upon it as upon property representing actual sacrifice by investors. They deem it unjust to ask the public to provide both capital and return. While such a surplus may be the property of the carrier, the claim is that the circumstances attending its accumulation impose a duty upon the carrier at least to share its advantages with the public, and that this duty may be considered in valuation for rate-making purposes.

It is not a sufficient answer to this doctrine to say that the property acquired from surplus earnings is *owned* by the carrier, for the rights of ownership are not absolute, but limited by the dedication of the property to the public use and the circumstances of such dedication. Nor is it enough to say that the surplus might have been distributed to the stockholders at the time it was earned, for the public might well have declined to acquiesce in rates producing excess income if that income had not been used for the improvement of the property. The question has many aspects. It would be a curious anomaly to accept the theory that rates should be high enough to permit the investment of income in nonrevenue-producing improvements, and then hold that a company may exact a return upon such property. It would be just as anomalous to approve the building up of sinking funds for the retirement of debt, and then permit the exaction of a return upon the property for which the debt so retired was incurred, or permit its recapitalization. Over $31,000,000 of applicant's surplus was derived from the retirement of debt in this manner, and more than $10,000,000 is represented by sinking funds in process of accumulation.

The courts have said that a carrier is entitled to a reasonable return upon the fair value of its property, but the full meaning of the words "fair value" still remains to be determined. "The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts." *The Minnesota Rate Cases,* 230 U. S., 352, 434. Without undertaking to argue the point now, I think it is clear that the word "value," as it has thus been used by the courts, has a meaning quite different from that which it carries in ordinary usage. It

has been said that the determination of such value is "the determination of what, under all the facts and circumstances of the case, is the just and equitable amount upon which the return allowed to the corporation is to be computed."

I make no claim that the Supreme Court of the United States has yet conclusively determined that property acquired from excess earnings is to be treated differently from other property in valuation for rate-making purposes. I do believe that this is still an open question. In *Louisiana R. R. Comm.* v. *Cumberland Tel. Co.*, 212 U. S., 414, the court apparently takes the ground that extensions or improvements constructed from the proceeds of reserves set aside for depreciation are not to be included in the fair value, but states—

> We are not considering a case where there are surplus earnings after providing for a depreciation fund and the surplus is invested in extensions and additions. We can deal with such a case when it arises.

In no subsequent case has the court held that property acquired from surplus earnings after the payment of reasonable dividends is to be included on equal terms with other property in determining the "fair value" upon which rates are to be based. Nor, if we assume that this will be the decision, has it held that the "reasonable return" upon the portion of the value representing such surplus accumulations must correspond with and be as high as the "reasonable return" upon the remainder.

In *Advances in Rates—Eastern Case,* 20 I. C. C., 243, 270, after considering the claim that the carriers should be allowed to invest in improvements an amount equal to that paid in dividends to stockholders, we said—

> It is evident that until the status of this surplus is determined by legislative action or judicial interpretation, this Commission can not properly permit an advance in rates with the intent to produce an accumulation of surplus for this purpose.

The status of surplus accumulations is still undetermined "by legislative action or judicial interpretation," and it would be an equally valid conclusion in the pending case that, until this be done, we can not properly grant the authority sought.

More recently, in *The Fifteen Per Cent Case,* 45 I. C. C., 303, 315, we said—

The theory of this character of testimony seems to be that property donated and property paid for out of revenues of carriers does not in fact become their property in the sense that they may be permitted or are entitled to earn a reasonable return thereon, and that the public having donated certain property or having contributed to the revenues of the carriers through the payment of freight charges and passenger fares in reality owns such property and therefore can not lawfully be asked to pay rates and fares which will yield a return on such property. These are questions of large import which have been directly raised in valuation proceedings now pending before us and which will not be discussed here.

The valuation proceedings are still pending and these "questions of large import" so raised are still to be discussed and decided in connection with those proceedings.

The carriers are inclined to ridicule the suggestion that these surplus accumulations are held in any way as a trust fund in behalf of the public. From one standpoint this ridicule may be justified; but nevertheless there is, I believe, a trust in connection with these accumulations. The trust is upon us. Whatever may be our views as to the merits, we ought to take no action which will foreclose or impair the opportunity to bring this issue fairly before the Supreme Court. To permit the capitalization of surplus will, I fear, do this very thing. The danger is illustrated by *Willcox* v. *Consolidated Gas Co.*, 212 U. S., 19, where the court included in the value of the property $7,781,000 representing the value of franchises, merely because such amount had been recognized by the legislature in considering the capitalization of the company at an earlier date. The court concluded its discussion of this matter with the following paragraph:

What has been said herein regarding the value of the franchises in this case has been necessarily founded upon its own peculiar facts, and the decision thereon can form no precedent in regard to the valuation of franchises generally, where the facts are not similar to those in the case before us. We simply accept the sum named as the value under the circumstances stated (page 48).

The danger involved is the more important because the question at issue is closely allied to the question involved in the recapture of excess earnings under section 15a of the interstate commerce act. Indeed, in argument before us upon the application of the Delaware, Lackawanna & Western for authority to capitalize surplus, counsel for the Association of Railway Executives urged the right

of stockholders to all the earnings of the property in substantially the same terms that have been employed in questioning the validity of the recapture provisions of the present act.

Summing up this phase of the matter, applicant may have a right to a return upon its surplus, but whether or not the surplus shall be translated into stocks and bonds is subject to our determination under the law; and whatever right to a return it has can not be lost by the denial of the authority desired. On the other hand to grant the desired authority may prejudice and embarrass the decision of a question which has far-reaching importance.

But there is a further ground for denial, entirely separate and distinct. Assume all the carriers claim with respect to the first ground, does it then follow that the stock and bond dividends proposed are "compatible with the public interest"?

At this point we hark back to the reasons for surplus accumulations which have been urged upon us over and over again. No better proof that such accumulations do improve credit could be offered than the testimony that applicant is now able to issue $80,000,000 of bonds for cash on a 6 per cent basis. How many carriers can do this under present conditions? If its credit has thus been enhanced, will it not be impaired by the addition of $4,800,000 per year to its fixed charges and by the capitalization of all but a comparatively small portion of its surplus? And has the public no interest in such impairment?

Consider the matter from another angle. Our attention has repeatedly been called to the danger of a disproportionate increase in funded debt and we have been told that it is vital that the carriers should be able to finance their needs in part by the issue of stock. With its present capitalization applicant is one of the very few railroads in the country which could probably market stock—if not common, at least preferred—even under present conditions. Will not the distribution of $60,000,000 of stock gratis impair this ability to some extent at least? The sole reason offered for this stock dividend seems to be the alleged necessity of affording a basis for the continual increase of funded debt under the new mortgage up to an ultimate ratio of $3 of bonds for every $1 of stock, a ratio far in excess of what we have been told is safe and proper.

And if *stock* dividends are not open to question, what shall be said of *bond* dividends? After its stockholders have foregone extra dividends for years and approved the use of surplus earnings for

improvements in times when money could have been borrowed at 4 per cent or better, can it be argued that it is sound financial policy to permit applicant to reverse this procedure and borrow money on the worst market in its history, for the purpose of reimbursing stockholders for their previous moderation? To ask this question is to answer it. The surplus has been invested in property. Even if the stockholders have a right to demand a return upon that property, they are certainly not entitled to ask that applicant now issue mortgage bonds for the sake of replacing in the treasury, for distribution in dividends, the cash which was so invested.

The truth is that applicant, as it is now capitalized, is one of the fortunate carriers of the country. If all other carriers had been financed with equal conservatism and sound financial judgment our railroad problem would be far less serious. Its credit is unsurpassed, its stockholders seem assured of regular and dependable returns; for 20 years they have had dividends averaging more than 8 per cent, and if they should now wish to reap the reward of good management by increasing the regular dividend rate somewhat or by occasional extra dividends, there are few who would question the appropriateness of such action. Applicant ought not, I think, in the public interest or in its own interest, to be permitted to abandon this position of advantage in the absence of compelling need by greatly increasing the volume of its outstanding securities and the measure of its fixed charges. Rather, it ought to avoid unnecessary increase in capitalization and finance its own actual needs by the issue of stock, or if this is for the time being impracticable, by the issue of bonds and stock in equal proportions.

Certain minor reasons for the issue of the proposed stocks and bonds have been urged that warrant brief comment.

1. It is suggested that applicant is in need of a more modern and flexible mortgage and that the declaration of a stock dividend of $60,000,000 is necessary to afford a suitable basis for the issuance of bonds under such mortgage.

If applicant is right in its contention that this stock will add nothing to the value of the property upon which it is entitled to a return, the *real* foundation for the issuance of bonds will in no wise be enlarged by the stock dividend, but only the *apparent* foundation. It is the amount of property and its earning power which determine the debt which may safely be carried and not the

par value of stock outstanding. Moreover, so long as applicant clings to the advantage of its present low capitalization, the stock basis for the issuance of bonds under the new mortgage can be enlarged from time to time by financing, in part at least, through new stock.

2. It is suggested that permission to declare stock and bond dividends will offer an encouragement to investment in railroad securities in general which is much to be desired.

Apart from the fact that denial of the application can in no way deprive the applicant of whatever right it may have to a return upon its property, it is evident that if all carriers were now in the fortunate situation of applicant, with splendidly buttressed credit and assurance of regular and generous dividends, no further encouragement would be needed for investment in railroad securities. The best encouragement that can be offered is insistence upon the sound and conservative financial management which has so far characterized this carrier.

3. It is suggested that if the application is denied, carriers will have no inducement in the future to use surplus earnings for additions and betterments, but that instead stockholders will insist each year upon the distribution of all available earnings.

This argument is based upon an assumption plainly contrary to the fact, namely, that the creation of uncapitalized surplus reserves, thus enhancing credit and the assurance of dependable dividends of liberal amount, is of no benefit to stockholders.

4. Our attention is called to paragraph 6 of section 5 of the interstate commerce act, which provides that in the event of consolidation of railroad companies the capitalization "shall not exceed the value of the consolidated properties," and it is suggested that in view of this provision we should encourage the gradual adjustment of the capital of carriers to the value of their properties.

This argument is based on what I think is the mistaken assumption that the words "shall not exceed" in the provision cited are equivalent to the words "shall equal." It is far from certain that consolidations of properties will necessitate capitalization of surplus reserves. The terms of future possible mergers are not now before us. They can be dealt with when the occasion arises.

The kernel of the application is the request for authority to issue $80,000,000 of bonds. The $60,000,000 stock dividend which

the majority have approved is a far less important part of the plan and, without the bonds, will be of relatively little consequence to applicant or its stockholders. From the public standpoint the objections differ only in degree. The application should, I feel, be rejected in its entirety. . . .

3. REFUNDING [1]

BY THE COMMISSION:

The Northern Pacific Railway Company and the Great Northern Railway Company, jointly, duly apply for an order under section 20a of the interstate commerce act approving their joint trust indenture to the First National Bank of the City of New York, as trustee, to secure an authorized issue of $230,000,000 of their joint 15-year 6½ per cent convertible gold bonds; approving a proposed issue by them of the entire $230,000,000 of those bonds, hereinafter called joint 6½s; approving a proposed pledge by them under the indenture of 1,658,674 shares of the capital stock of the Chicago, Burlington & Quincy Railroad Company; approving a proposed issue and pledge thereunder by the Northern Pacific Railway Company, of $33,000,000 of its refunding and improvement mortgage gold bonds, series B; approving a proposed issue and pledge thereunder by the Great Northern Railway Company, of $33,000,000 of its general-mortgage gold bonds, series A; approving the general gold-bond mortgage of the Great Northern Railway Company to secure bonded indebtedness as provided therein; and approving the proposed issuance by either applicant, in event either of payment of joint 6½s or of conversion thereof as in the indenture provided, of its respective mortgage bonds against deposits of such stock as provided in the indenture and mortgages. The general gold-bond mortgage of the Great Northern Railway Company, approval of which is sought herein, obligates that company to pledge thereunder $12,132,000 of its first and refunding mortgage gold bonds and, subject to an existing pledge with the Secretary of the Treasury, an additional $24,200,000 of similar bonds.

A hearing upon the application was held on April 11, 1921. Due notice of the filing of the application and of the hearing was given. At the hearing there were no appearances except in behalf

[1] *Application of Northern Pacific Railway Company and Great Northern Railway Company for Authority to Issue Securities*, 67 I. C. C. 458 (April 21, 1921). See Jones, pp. 590–593, and Vanderblue and Burgess, p. 368.

of the applicants. No objection to the granting of the application has been offered by any authority of any state in which either applicant operates.

There have been filed in this proceeding copies of the indenture, dated July 1, 1921, as executed on May 3, 1921; of the Northern Pacific Railway Company's refunding and improvement mortgage; of the Great Northern Railway Company's general gold-bond mortgage, as executed on May 3, 1921; and of its first and refunding gold-bond mortgage. Each such instrument prescribes the form of the bonds issuable thereunder.

The applicants are common carriers by railroad engaged in interstate commerce. Their application grows out of the necessity of paying or refunding $215,227,000 of their 4 per cent joint and several bonds which are in the hands of more than 18,500 holders. These bonds, hereinafter called joint 4s, were issued under date of July 1, 1901, in payment for 1,076,135 shares of the capital stock of the Chicago, Burlington & Quincy Railroad Company of the par value of $100 per share. They are secured solely by the pledge of 1,658,674 shares of that stock owned by the applicants. They will mature July 1, 1921; and the applicants, lacking available funds with which to pay them, must issue and sell some form of securities sufficient in amount to raise substantially all of the $215,227,000 required. For this purpose they have decided to issue the joint 6½s; and the uncontradicted evidence is that the issuance thereof is the best means now available for obtaining the necessary funds.

The joint 6½s are to be issued under date of July 1, 1921. They will bear interest from that date at the rate of 6½ per cent per annum, payable semiannually on January 1 and July 1, will mature July 1, 1936, and will be callable for redemption, as a whole or in amounts of not less than $5,000,000, on 75 days' notice at 103½ per cent of par and accrued interest. Each holder of joint 6½s, whether or not they be called for redemption, will be entitled under section 1 of the third article of the indenture, to convert them at any time before maturity into a like principal amount of the Northern Pacific Railway Company's refunding and improvement mortgage bonds, series B, and/or of the Great Northern Railway Company's general-mortgage gold bonds, series A. But this right of conversion into the mortgage bonds of either applicant will cease when $115,000,000 of its bonds, less an amount equal to one-half of the principal amount of

joint 6½s redeemed, shall have been issued upon such conversion. Upon each conversion, except when made upon an interest date, accrued interest will be adjusted in cash. The evidence shows that the calling of joint 6½s for redemption would probably result in the conversion of the greater part of the bonds so called.

Many of the joint 4s are held by insurance companies, savings banks, trust companies, trustees, and other similar investors. In several of the chief investment states bonds secured by stock collateral alone can not now be lawfully purchased and held by such investors. It is believed, however, that the provision for conversion will not only enable the applicants to reach this market but will also insure the early substitution of mortgage bonds for a considerable portion of the joint 6½s without any calling of the latter for redemption.

The indenture obligates the applicants to pledge thereunder the above-mentioned 1,658,674 shares of stock. It provides, also, that each applicant shall pledge thereunder $33,000,000 of its mortgage bonds.

Between July 1, 1914, and December 31, 1920, the Northern Pacific Railway Company expended for additions and betterments properly chargeable to capital account $45,208,083.66, none of which has been capitalized. It now proposes to reimburse its treasury in part for these expenditures by drawing down on account thereof, under the fourth article of its refunding and improvement mortgage to the Guaranty Trust Company of New York, having date July 1, 1914, $33,000,000 of series-B bonds, and to pledge the same under the indenture. These bonds will be dated January 1, 1921, mature July 1, 2047, bear interest from July 1, 1921, at the rate of 6 per cent per annum, payable semiannually on January 1 and July 1, and be callable for redemption after July 1, 1936, on any interest date on three months' notice at 110 per cent of par and accrued interest.

The Northern Pacific Railway Company's mortgage reserves, of the bonds issuable thereunder, $222,400,000 for issuance from time to time for the purpose of purchasing, paying, or retiring joint 4s before, at, or after their maturity. Section 4 of the third article thereof provides that $1,000 of the bonds so reserved may be issued for each $500 of the pledged stock upon its release from pledge and deposit with the trustee thereunder. That company seeks authority to issue from time to time, pursuant to this pro-

vision, its mortgage bonds to an aggregate amount of not more than $107,000,000. These bonds will be series-B bonds, similar in all respects to the $33,000,000 of its bonds above described.

The maximum interest rate permissible under the Great Northern Railway Company's first and refunding gold-bond mortgage is 5 per cent. That company can not procure the issuance of bonds thereunder against deposits of the stock, unless it deposits a majority of the issued and outstanding shares. It does not own a majority of the shares. It therefore determined to execute and deliver under date of January 1, 1921, to the First National Bank of the City of New York its general gold-bond mortgage. Section 5 of the third article thereof provides for the issuance of $140,000,000 of series-A bonds to be dated July 1, 1921, mature July 1, 1936, and bear interest at the rate of 7 per cent per annum, payable semiannually on January 1 and July 1. These bonds will not be redeemable before maturity.

The Great Northern Railway Company proposes to draw down under that section and to pledge under said indenture $33,000,000 of series-A bonds. The remainder, $107,000,000, thereof are reserved by that section for issue from time to time for the purpose of exchanging, redeeming, or retiring upon surrender for conversion, in accordance with the terms of the indenture, a like principal amount of the joint 6½s. Authority is sought to issue, from time to time, pursuant to this provision, series-A bonds to an aggregate amount of not more than $107,000,000.

The mortgage bonds of each applicant, including, when and as released, those pledged under the indenture or such part thereof as may be required, will be used, or available for use, upon conversion of the joint 6½s.

The indenture provides that, upon any redemption of joint 6½s, the trustee thereunder shall release to each applicant in respect of each $1,000 of bonds so redeemed $100 of its pledged mortgage bonds and $385, par value, of the pledged stock. It also provides that, upon any surrender of joint 6½s for conversion into the mortgage bonds of either applicant, the trustee shall release to that applicant, for each $100 of bonds so surrendered and against delivery to the trustee of $100 of such applicant's mortgage bonds, $77, par value, of the pledged stock and $20 of its pledged mortgage bonds. Each redemption or conversion of joint 6½s will, therefore, result in a partial severance of the applicants' joint ownership of the stock.

There have been issued and are actually outstanding $35,668,000 of the Great Northern Railway Company's first and refunding mortgage gold bonds due May 1, 1961. There have been pledged with the Secretary of the Treasury to secure a loan to that company, under section 210 of the transportation act, 1920, $24,200,000 of similar bonds. It is desirable that this company's general gold-bond mortgage be a first lien on a majority of the bonds issued and outstanding under its first and refunding gold-bond mortgage. Therefore, it proposes to close its first and refunding gold-bond mortgage with $72,000,000 of bonds issued and outstanding thereunder, of which $35,668,000 will remain in the hands of the public. The balance, $36,332,000, will be pledged under the general gold-bond mortgage, which provides for the pledge thereunder of $24,200,000 of such bonds, subject to the existing pledge thereof with the Secretary of the Treasury, and of an additional $12,132,000 thereof now held by the company unencumbered in its treasury.

The applicants proposed in their application to issue and sell the joint 6½s at some convenient time on or before July 1, 1921, through contract with a syndicate of bankers, upon the syndicate's undertaking to provide on or before that date the moneys needed to pay the joint 4s. The applicants proposed to sell the joint 6½s at the best prices obtainable at the time when their issue might be authorized, and represented that it was impossible to obtain definite prices in advance of such authorization. It was shown at the hearing that the joint 6½s probably could not be sold to the public for more than 96½ per cent of par and accrued interest, and that the cost to the applicants of marketing the same, including a reasonable compensation to the syndicate and to the distributors, would be about 5 per cent of the principal amount of the bonds. On this basis the joint 6½s will be purchased by the syndicate at approximately 91½ per cent of par as of July 1, 1921. The effective rate of interest will be very high; but the uncontradicted evidence is that the terms mentioned are the best which can be obtained at the present time. It will be necessary for the applicants to provide some funds from other sources in order to pay the joint 4s. This the evidence shows they will be able to do.

The outstanding capitalization of the Northern Pacific Railway Company as shown by its general balance sheet of December 31, 1920, is as follows:

Capital assets:	
Investment in road	$435,313,798.17
Investment in equipment, less accrued depreciation	46,540,245.09
Charges since December 31, 1919	8,586,275.15
Sinking funds	3,019.94
Deposits in lieu of mortgaged properties sold	594,150.83
Miscellaneous physical property	7,485,182.20
Investment in affiliated companies	186,643,780.83
Other investments	9,773,669.30
Total	694,940,121.51
Capital liabilities:	
Capital stock—Common	$248,000,000.00
Grants in aid of construction	3,406.60
Funded debt	315,065,000.00
Total	563,068,406.60

The corporate income accounts of the Northern Pacific Railway Company for the years 1909 to 1919, inclusive, show the following net income applicable to dividends and income surplus transferred to profit and loss:

Year ended	*Net income.*[1]	*Income surplus transferred.*
June 30, 1909	$21,639,140.09	$7,534,350.09
June 30, 1910	22,295,944.34	4,936,259.36
June 30, 1911	20,441,846.50	3,082,266.50
June 30, 1912	19,661,714.62	2,303,814.62
June 30, 1913	21,809,464.37	3,453,517.82
June 30, 1914	19,892,228.53	2,295,247.36
June 30, 1915	18,819,040.33	1,462,820.33
June 30, 1916	25,729,873.65	8,369,873.65
Dec. 31, 1916	26,948,010.87	9,588,010.87
Dec. 31, 1917	29,502,685.59	12,142,685.59
Dec. 31, 1918	20,129,334.45	2,769,334.45
Dec. 31, 1919	22,836,736.74	5,476,736.74

The corporate income account of the Northern Pacific Railway Company for the year ended December 31, 1919, shows the following with respect to deductions from gross income:

Interest on funded debt	$12,117,483.28
Interest on unfunded debt	214,862.57
Rent for leased roads	51,331.86
Miscellaneous rents	10,026.33
Miscellaneous income charges	413,961.34
Total	12,807,665.38

The outstanding capitalization of the Great Northern Railway Company as shown by the general balance sheet of December 31, 1920, is as follows:

[1] The regular 7 per cent dividends on the common capital stock were paid during this period.

Capital assets:	
Investment in road and equipment less accrued depreciation	$393,991,808.60
Improvements on leased railway property	21,703.23
Sinking funds	3,394.96
Deposits in lieu of mortgaged property sold	188,000.02
Miscellaneous physical property	4,917,414.86
Investments in affiliated companies	226,837,219.43
Other investments	8,516,357.66
Total	634,475,898.76
Capital liabilities:	
Capital stock—Preferred	$249,477,150.00
Premium on capital stock	81,268.44
Governmental grants in aid of construction	168,355.22
Funded debt unmatured	257,606,515.16
Nonnegotiable debt to affiliated companies	324,547.20
Total	507,657,836.02

The corporate income accounts of the Great Northern Railway Company for the years 1909 to 1919, inclusive, show the following net income applicable to dividends and income surplus transferred to profit and loss:

Year ended	*Net income.*[1]	*Income surplus transferred.*
June 30, 1909	$16,633,290.45	Dr. $847,341.23
June 30, 1910	17,932,518.87	916,885.03
June 30, 1911	17,516,754.04	———
June 30, 1912	20,903,924.05	2,703,273.30
June 30, 1913	24,354,814.93	4,277,989.61
June 30, 1914	19,880,501.78	3,311,122.14
June 30, 1915	20,427,728.69	2,099,540.05
June 30, 1916	27,625,169.28	2,311,582.37
Dec. 31, 1916	24,290,045.15	Dr.1,040,034.18
Dec. 31, 1917	23,021,751.66	112,682 66
Dec. 31, 1918	18,793,845.93	690,420.21
Dec. 31, 1919	22,146,144.58	2,107,025.06

The corporate income account of the Great Northern Railway Company for the year ended December 31, 1919, shows the following with respect to deductions from gross income:

Interest on funded debt	$11,735,927.01
Interest on unfunded debt	183,691.90
Miscellaneous rents	10,415.60
Miscellaneous tax accruals	111,964.53
Amortization of discount on funded debt	266,666.64
Miscellaneous income charges	692,131.71
Total	13,000,797.39

The proposed issue of joint 6½s will increase the fixed annual interest charges of each of the applicants by $3,170,460, provided

[1] The regular 7 per cent dividends on the preferred capital stock were paid during this period.

that none of the bonds are converted. Assuming a conversion of half the issue into the 7 per cent bonds of the Great Northern Railway Company and half into the 6 per cent bonds of the Northern Pacific Railway Company, the fixed annual interest charges would then be further increased by $575,000 in the case of the Great Northern Railway Company and be correspondingly decreased by $575,000 in the case of the Northern Pacific Railway Company. These figures do not reflect the additional cost to either applicant resulting from the sale of the joint 6½s at a discount.

The applicants have had their joint 4s outstanding for nearly 20 years. During that time they have made good earnings but have not reduced the principal amount of this obligation. The interest thereon has been more than met currently by their dividends from the Burlington stock, to purchase which the joint 4s were issued. The near approach of maturity presents the alternative of default, or of such refinancing as now appears to be practicable. And the testimony is that an extension or refunding of the present loan for a short term would be of no material benefit to applicants. The situation presents an emergency and we must deal with that situation as it is.

We approve the applicants' joint trust indenture and the general mortgage of the Great Northern Railway Company in the respective forms as executed on May 3, 1921, and filed with us.

We find that the proposed issue and sale of the joint 6½s, the proposed issue and pledge of mortgage bonds of the Northern Pacific Railway Company, the proposed use thereof upon conversion of joint 6½s, and the proposed issue of its mortgage bonds upon payment or conversion of joint 6½s (*a*) are for lawful objects within its corporate purposes, and compatible with the public interest, which are necessary and appropriate for and consistent with the proper performance by it of service to the public as a common carrier, and which will not impair its ability to perform that service, and (*b*) are reasonably necessary and appropriate for such purposes.

We find, also, that the proposed issue and sale of the joint 6½s, the proposed issue and pledge of general-mortgage gold bonds of the Great Northern Railway Company, the proposed use thereof upon conversion of joint 6½s, the proposed issue of its general-mortgage gold bonds upon payment or conversion of joint 6½s, and the proposed pledges of its first and refunding mortgage gold

bonds (*a*) are for lawful objects within its corporate purposes, and compatible with the public interest, which are necessary and appropriate for and consistent with the proper performance by it of service to the public as a common carrier, and which will not impair its ability to perform that service, and (*b*) are reasonably necessary and appropriate for such purposes.

An appropriate order will be entered.

POTTER, *Commissioner*, concurring:

It appears to me that there is reason to apprehend that the dissenting opinions of COMMISSIONERS MCCHORD and EASTMAN may leave erroneous impressions regarding the views of the Commissioners who concur in the majority report. I therefore make the following expression of my own views.

Attention has been called to the fact that the proposed plan for financing the Burlington joint 4s is expensive, and for this reason is hostile to the interests of the public and of the carriers. Undoubtedly the carrying out of the plan will be expensive. It should be pointed out, however, that the element of expense is due in substantial part to the fact that we declined to approve of the plan submitted to us on the application of the Burlington, and forced the utilization of the more expensive plan now submitted.

There is a suggestion of criticism because of the fact that the Great Northern and the Northern Pacific acquired the Burlington stock. I fail to see wherein we have license to criticize that transaction. Its merit is not involved in this case. There has been no inquiry regarding the propriety of it, and there is no record upon which fairly it could be criticized. It has stood unquestioned for 20 years, and for the purpose of this proceeding must be presumed by us to have been sound. Beyond this, the phenomenal record made by these three properties during the last 20 years in fairness should be regarded as justifying the relation which existed between them. That relation seems to harmonize with the consolidation provisions of the transportation act and to indicate that those who were responsible for it were leaders about 20 years ahead of the leaders of the present day.

It is suggested that some sinking-fund scheme should have been followed heretofore. A sufficient answer is that no such plan was adopted, and we must deal with conditions as we find them. It has not been pointed out how any sinking-fund scheme would have been helpful. The carriers have not, during the last 20 years,

disbursed any undue or disproportionate amounts in dividends. They have spent vast sums for additions and betterments which were needed in the public interest. Any sinking-fund scheme which would have withdrawn earnings with which to retire the Burlington joint 4s would have served no purpose except to force the issuance of other securities with which to replace the moneys which the sinking fund would have taken. Under the plans which universally have prevailed a large part of capital invested in railways has been represented by bonds. This has been in the public interest, and this method of financing undoubtedly will continue. The plan represents sound financing and has been forced by necessity as the best method. It would not have been and could not have been used if it were not supported by sound economic reasons. It is likely that when the Burlington joint 4s were put out the 20-year maturity was decided upon because it was believed that they could be refunded on a basis better than 4 per cent—which probably could have been done except for the world war.

The suggestion that an extension of two or three years should have been obtained has been answered by testimony that it is impossible to obtain such an extension. The intimation that a forced refunding on a 6 per cent basis should have been resorted to suggests a policy of repudiation which should not be encouraged by us. In this country the investor has the right to choose the investments which he will make. When, as in this case, he is entitled under the contract which he holds to receive a definite amount at a certain time, he has the right to demand that amount in the medium which his contract provides. To force an investor to receive in payment of his debt another security worth only 80 or 90 cents on a dollar would represent a policy of dishonesty, which we, on behalf of the American public, have no right to enforce and approve.

The situation before us is relatively simple. The joint 4s must be met on July 1, 1921, if the credit of the applicants and railroads generally is to be preserved. The results of a denial of this application would be disastrous to the railroads and to the public. The officers, directors, financial advisers, attorneys, and (practically without exception) the stockholders of each applicant have approved of the plan submitted. A public hearing has been had. No objection to the granting of the application has been offered by any state authority. There was no appearance at the hearing in opposition to the application. Full explanation was given regard-

ing existing conditions in the financial and investment market. It probably would be impossible to put through any other plan by July 1. This application and the prior application by the Burlington have invited and urged our assistance for more than six months. The uncontradicted evidence is that the method proposed, despite its cost, is the best available and the only one the success of which is virtually assured.[1]

McCHORD, *Commissioner*, dissenting:

In view of its tremendous importance and far-reaching consequences, the very large amount involved, and the effect upon our future action, I regret very much that I am unable to concur in the view of the majority. The plan submitted by the northern lines is, in my judgment, so expensive and so at variance with the spirit and purpose of the amended act, and so foreign to the interests of the public and the carriers, that I am constrained to withhold my assent. Among the details recited in the majority report certain striking facts stand out. Twenty years ago the northern lines jointly acquired approximately 97 per cent of the capital stock of the Burlington, and to obtain the funds necessary for the purchase, issued their joint and several 4 per cent bonds, aggregating $215,227,000, maturing July 1, 1921, collaterally secured by deposits of the capital stock so purchased by them. During that period the Burlington dividends have paid the interest upon the joint 4s, the northern lines have distributed dividends upon their own capital stock, and have expended various sums in maintenance, betterments, and extensions; but nothing has been set aside as a sinking fund to retire any part of their bond issue, and at the end of the 20-year period they have failed to cancel a single dollar of the indebtedness incurred for the sole purpose of obtaining control of another trunk line. To postpone the day of reckoning they now propose a joint refunding issue of $230,000,000, initially increasing their outstanding obligation by approximately $15,000,000, to be floated in accordance with a plan which will net them about $210,000,000, after deducting the discount and underwriting costs. Thus, at the threshold, not only are they faced with an expenditure of approximately $20,000,000 to accomplish merely the flotation of the issue, but the net proceeds will fall

[1] The issue of $230,000,000 joint convertible 6½ per cent bonds was successfully sold, and represented the largest piece of corporate financing in the history of railroad transportation.—Ed.

almost \$5,000,000 short of the principal sum necessary to meet and retire the outstanding joint 4s, and, as frankly admitted, this deficit must be "dug up" from other sources. This is not all; they are to assume a 15-year undertaking to pay an interest rate increased by more than 50 per cent per annum, which will aggregate over \$86,000,000 additional fixed charges for that period, based upon a principal enlarged by nearly \$15,000,000 and callable at 3½ per cent above par, equal to 12 per cent of par in excess of the initially available net. So, also, in the event the privilege of the conversion into the Northern Pacific 6s is exercised, within the prescribed limits, those bonds, although enjoying a lower interest rate, are callable after 15 years at a premium of 10 per cent of par.

The foregoing brief review discloses the prodigality of the transaction, the cost of which must sooner or later be met by travelers and shippers or else impair by so much the resources of the applicants. Having been unable during a period of 20 years to abate a single dollar's worth of their outstanding joint 4s, there is scant hope that the northern lines will be able to reduce the new and more burdensome undertaking or even recoup the initial sacrifice with which it is to be launched, and the approval by the majority includes no such requirement for the future. Certainly, the present progression is in the direction of disaster. This is not a matter of negotiating a loan with which to continue those lines as going concerns, but solely to enable them to retain control of the Burlington; and it can not be successfully contended that the present scheme is necessary to maintain this triple alliance as a transcontinental system, in view of our power to prescribe through routes and joint rates and to provide for joint use of terminals upon appropriate terms.

Viewing the matter from all angles, I think we should limit our authorization to an issue of refunding bonds of the northern lines in an amount sufficient to retire the maturing issue, bearing interest at a rate of 6 per cent and secured by the joint mortgage and by the collateral now having a materially increased value, to be exchanged par for par by negotiation with the present bondholders. An admissible alternative would be an appropriate extension or renewal of the present obligations for a further period of something like two or three years, even at 7 per cent, the present indications being that the interest rate has passed the peak and will then have declined to a reasonable figure; and before the expiration of that

time steps could be taken to place refunding bonds in the hands of investors on less costly terms. . . .

4. Capital Stock without Par Value [1]

By the Commission:

The El Paso & Southwestern Company, a common carrier by railroad engaged in interstate commerce, has duly applied for authority under section 20a of the interstate commerce act to issue 750,000 shares of capital stock without par value. No objection has been made to the granting of the application.

The applicant proposes to amend its certificate of incorporation so as to change its present authorized capital stock of $35,000,000, divided into 350,000 shares of the par value of $100 each, into 1,000,000 shares of capital stock without nominal or par value. Of the new shares, 750,000 will be issued to the present stockholders in exchange for their stock. There are 250,000 shares, of an aggregate par value of $25,000,000, now outstanding. The proposed exchange, therefore, will be on a basis of three shares of the new stock for one of the old. Appropriate resolutions were adopted by the applicant's board of directors on December 23, 1920, and the proposed amendment was approved unanimously at a meeting of stockholders held February 8, 1921, at which all of the stockholders were present or represented. It appears that such amendment is authorized by the general corporation act of New Jersey, under which the applicant was incorporated.

Of the shares authorized by the proposed amendment, 250,000 are for the present to remain unissued, subject to the future requirements of the carrier. No other change in the applicant's financial structure is now contemplated.

We find that the proposed issue and exchange of capital stock without par value by the applicant as aforesaid (*a*) are for a lawful object within its corporate purposes, and compatible with the public interest, which is necessary and appropriate for and consistent with the proper performance by it of service to the public as a common carrier, and which will not impair its ability to perform that service, and (*b*) is reasonably necessary and appropriate for such purpose.

An appropriate order will be entered.

[1] *Application of the El Paso and Southwestern Company for Authority to Issue Capital Stock without Par Value*, 70 I. C. C. 208 (July 18, 1921). See Jones, pp. 11–12.

EASTMAN, *Commissioner*, dissenting:

I have been unable in this case to discover good reason for permitting the substitution of three shares of stock without par value for every share of par value stock. Applicant operates in the states of Arizona, New Mexico, and Texas, and in Mexico a system of railroad companies, which it controls through stock ownership or lease or both. It owns no railroad property except equipment. It has outstanding stock of the par value of $25,000,000 and no funded debt, and on December 31, 1919, its surplus amounted to $16,327,599. The record shows that dividends of 8 per cent were paid in 1917, 1918, 1919 and 1920, but is silent with respect to the dividends paid prior to 1917.

Applicant believes that its "present capital stock of $25,000,000 is in itself a misstatement of the value of the property as it stands today," and apparently thinks that this fact may prejudice the valuation which we now are making. It feels that it has a "right to ask that that valuation shall not be prejudiced, or affected injuriously or otherwise, by the par value of the outstanding capital stock." The view is also expressed that "there is a great prejudice in this country against the payment of large dividends per share," and applicant claims that it is "entitled to be free from difficulties of combatting that principle, that feeling."

There is more in the same vein, but the reasons advanced for the issue of stock with no par value may briefly and fairly be summarized as a fear that the outstanding par-value stock may operate as a restraint upon us in fixing the value of the property, plus a desire to be able to increase dividend payments in a less conspicuous way than is now possible. No reasons of more substance than these are offered, and no claim is made that the existing par-value stock has in any way hindered the development of the company or checked its prosperity.

The petition might well be dismissed for failure to make a case, but there are positive reasons for denial. Of late a strong movement has developed in favor of the issue of stock without par value by railroads and public utilities. It is, I think, significant that this movement has coincided with the rapid growth of public regulation of security issues. Whether or not stock with no par value is desirable in the case of ordinary industrial enterprises I do not undertake to say, but I entertain little doubt that so far as public service corporations are concerned, it is the manifestation of an unsound tendency subversive of the public interest.

Those who favor no par value are wont to say that stock with par value is misleading, because par value seldom, if ever, represents correctly the *actual* value of the property. But no one is misled, for it has been well and commonly known for many years that par value and actual value are not the same thing. The theory of par value is only that it represents cash or its equivalent that has been invested in the property. The trouble in the past has been that loose and pernicious corporation laws have made this true merely in theory and not in practice. Now that these laws are being corrected, we have the movement in favor of stock with no par value.

My conviction is that the doctrine of so-called "value" is full of pitfalls, and that the path to soundness and stability in public service corporation finance under private management lies instead in the recognition and protection of investment honestly and prudently made. The distinguishing feature of a public service corporation is that it is monopolistic in nature and entitled to make only just and reasonable charges for its services. Those charges are just and reasonable which in the aggregate meet the reasonable cost of the services, including in that cost a sufficient return, fluctuating if need be with changing conditions, upon legitimate investment to induce a continuing influx of necessary capital. If such charges are permitted, no claim of confiscation can possibly be sustained.

Under public regulation, investment is a thing definite, certain, and easily ascertained. So-called "value," as the word is now used in railroad and public-utility circles, is a thing of uncertainties, contradictions, artificialities, metaphysical subtleties, absurdities, and opportunities for public plunder. I am fully persuaded that it is desirable and in the public interest that outstanding capitalization should represent as nearly as practicable legitimate investment, and that the return upon that investment should clearly appear without disguise of any sort. We are a long distance from that now but can at least move in the right direction. Stock without par value in my opinion is a step in the wrong direction and toward speculation, instability, and confusion of the public mind.

CHAPTER XXI

REGULATION OF MANAGEMENT

1. New Construction [1]

A. General Principles [2]

The requirement of the law that a certificate of public convenience and necessity shall be required as a condition precedent to the construction and operation of new lines of railroad, is as follows:

> "No carrier by railroad subject to this Act shall undertake the extension of its line of railroad, or the construction of a new line of railroad, or shall acquire or operate any line of railroad, or extension thereof, or shall engage in transportation under this Act over or by means of such additional or extended line of railroad, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line of railroad."

This section was enacted pursuant to a recommendation of the Interstate Commerce Commission in its annual report for 1919. The legislative history of the new section shows that it was intended, first, to aid in stabilizing the credit of existing railroads; second, to help in solving the problem of the "weak roads," by preventing new construction which gives little promise of financial success; and third, to operate in furtherance of the consolidation program contained in other sections of the Act.

The tests which the Interstate Commerce Commission is required to apply in determining whether or not there shall be new railroad construction are not clearly defined. The only condition precedent to the granting of such a certificate in the law itself is a finding "that the present or future public convenience and ne-

[1] See Vanderblue and Burgess, pp. 293–299, 354–356, and Jones, pp. 558–559.

[2] From Kenneth F. Burgess, "Federal Regulation of Railway Management and Finance," *Harvard Law Review*, vol. 37, pp. 710–716 (April, 1924). Reproduced by permission.

cessity require or will require the construction, or operation" of such extension or new line. This terminology has been construed by the Commission to mean "urgent, immediate public need."

Grants of similar administrative discretion pertaining to railroad construction have been upheld when conferred by the legislatures of states upon state railroad commissions. While neither the state legislatures nor Congress could lawfully delegate to an administrative board, or to any other department of the Government, the determination of the constituent elements of public policy or public interest, there is little likelihood of the present legislation's being held void as a delegation of legislative power when the section is read and construed, as it should be, in the light of other sections of the Act of which it is a part. So construed, the essential "public convenience and necessity" includes the following tests: (1) whether or not the proposed line of railroad would probably be a financial success without burdening its connections through its demands for excessive divisions of joint rates; (2) whether or not the proposed construction would result in a parallel and competing line of railroad which would satisfy only a local demand and interfere with the strengthening of existing railroads; and (3) whether or not the proposed construction would complicate the consolidation of existing lines of railroad within the purview of Section 5 of the Interstate Commerce Act. In addition, any other definitions of public interest in the Interstate Commerce Act should be applied, such as the inhibition of the so-called commodities clause, designed to divorce transportation systems from manufacturing and mining enterprises.

In administering this section of the law, the Interstate Commerce Commission has not announced in concrete form the exact principles which it has applied in granting or denying these certificates. It has denied a certificate on the ground of the improbability of financial success on the part of the proposed railroad. On the other hand, even though doubt existed as to the adequacy of the prospective return, it has issued a certificate to permit the development of extensive coal deposits which would otherwise be retarded. In a number of cases it has issued certificates for the construction of branch lines to provide transportation facilities for new coal mining developments. In another case, Division 4 of the Commission denied a certificate for the construction of an extension to reach a proposed coal development, but

the full Commission on rehearing reversed the decision and issued the certificate.

Where intercorporate relationship was disclosed between the coal mining company and a new railroad corporation proposing to construct a line of railroad in a territory already well supplied with transportation, the Commission denied a certificate. As to a proposed railroad to be operated exclusively in intrastate commerce, a certificate was denied for lack of jurisdiction. But where an intrastate railroad sought to extend its operations to interstate commerce, a certificate was granted. In general, also, the applications of existing railroads to make extensions have been granted by the Commission. Likewise, the construction of new lines to eliminate terminal congestion has been approved.

The majority of the applications for certificates to construct and operate railroads have been uncontested and have been handled largely as routine matters. The applicant has been required to file a reply to a questionnaire describing the purpose, cost, public benefit, probable traffic, expected financial return, and other detailed matters in connection with the proposed construction or operation. In many instances no formal hearing has been held.

Probably the most interesting problem of law which arises under this section is the extent to which the Commission may prevent the building of new lines of railroad, in the event that the promoters proceed with construction without applying for a certificate or after one has been denied. Unless the Commission can prevent construction in such cases the practical benefits of the statute to the general public may be greatly impaired. For, as the Commission has said, "a railroad once built ordinarily must be operated and permitted to earn a living." Apparently with this thought in mind some railroad promoters have proceeded with the construction of a new line of railroad under a certificate of convenience and necessity issued by a state commission without securing a similar certificate from the Interstate Commerce Commission. Where such construction was commenced prior to the operative date of the new section of the Interstate Commerce Act, that is, prior to the expiration of the ninety-day period following February 29, 1920, no certificate is required by law. But where a railroad company already subject to the Interstate Commerce Act undertakes the construction of an extension or a new line of railroad, it may be

enjoined from proceeding until it has secured such a certificate from the Interstate Commerce Commission, even though the new line is intended only as an instrumentality of intrastate commerce. This is because its "unremunerative operation would or might burden or cripple the main line and thereby affect its utility for service as an artery of interstate and foreign commerce."

The difficult question arises where a new corporation undertakes new railroad construction within the boundaries of a state, contending that it will be, at least in the beginning, purely an instrumentality of intrastate commerce. It has been suggested that the Interstate Commerce Commission has no jurisdiction in such a case and that Congress could not legislate in respect thereto. An injunction to prevent the construction of a railroad within a state, where no certificate had been secured from the Interstate Commerce Commission, has been denied by a district court of the United States. No consideration appears to have been given by the court to the fact that the railroad intended to interchange cars with railroads engaged in interstate commerce under the Interstate Commerce Act.

It is a well-known fact that short-line railroads in general have an inadequate car supply and rely largely, if not exclusively, upon their connections to furnish them with cars with which to handle their traffic. The car supply of an interstate carrier is used interchangeably in interstate and intrastate transportation and, as such, the Interstate Commerce Commission may exercise plenary control in respect to distribution, and Congress may regulate in respect to safety devices. It is to be recalled that the section requiring certificates from the Interstate Commerce Commission applies to carriers "by railroad subject to this Act" (Interstate Commerce Act). By another provision of the same Act, Congress has provided

"that the provisions of this Act shall apply to common carriers engaged in the transportation of passengers or property wholly by railroad . . . but shall not apply to the transportation of passengers or property, or to the receiving, delivering, storage, or handling of property, wholly within one state. . . ."

In spite of this limitation, however, the Supreme Court has upheld the right of the Interstate Commerce Commission to prescribe intrastate rates in order to remove unjust discrimination

against interstate commerce. Where, therefore, a railroad corporation has applied to the Interstate Commerce Commission for a certificate of convenience and necessity to construct a railroad and such a certificate has been denied, or where it affirmatively appears that the new railroad will utilize existing instrumentalities of interstate commerce, such as freight cars, terminal facilities and the like, Congress may well have power to prevent such railroad construction as a necessary incident to its effective control of interstate commerce.

As to the necessity for a certificate from the Interstate Commerce Commission as a condition precedent to operation of a new line in interstate commerce, as distinguished from its construction, both the power of Congress and the provisions of the statute are clear. Congress may, in its plenary control of interstate commerce, impose whatever restrictions it deems proper upon those who seek to engage in it. It may even prohibit such commerce entirely. There can be no material difference between requiring those who seek to engage in such commerce by railroad to comply with fixed standards and the imposition of enrollment and license requirements upon vessels, or the condemnation of a bridge across a navigable river as an unlawful structure.

Under the present statute, the Interstate Commerce Commission, by withholding a certificate, may prevent the operation of a new line in interstate commerce. It may also, under the car-service sections of the Interstate Commerce Act, prevent the use of cars and locomotives of carriers subject to that Act, by railroads operating in intrastate commerce. Theoretically, these powers may constitute grave deterrents to those who would undertake new railroad construction without securing a federal certificate, but as a practical matter, they may fail to deal adequately with the real source of difficulty. When a new railroad is actually constructed and operated in intrastate commerce, it may be more embarrassing to refuse it permission to operate in interstate commerce than it would have been to prevent its construction altogether. The major part of the investment by the public has already been made and the local demands for the issuance of a certificate become much more insistent than they were before such a railroad was built. The exact limits of the Commission's power under the present law in this regard remain to be determined by the courts.

B. JEFFERSON SOUTHWESTERN CASE [1]

BY THE COMMISSION:

The original report denying the application, 76 I. C. C., 778, was issued on March 14, 1923. Subsequently, upon petition of the applicant, the case was reopened for further hearing and by the same order representatives of various interests of Mount Vernon, Ill., and of Jefferson County, in which it is situated, were allowed to

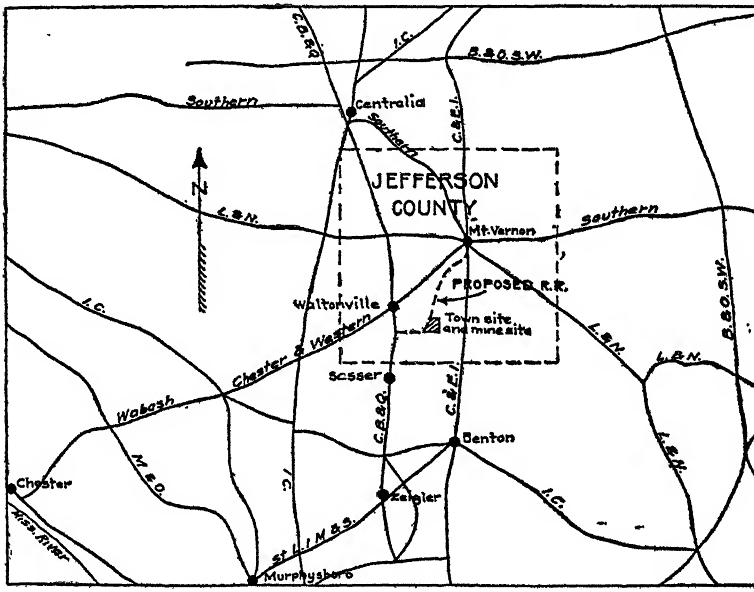


PLATE 21.—Railroads in Jefferson County, Illinois.

intervene. The rehearing was conducted for us by the Illinois Commerce Commission, and later the case was orally argued.

The evidence submitted at the rehearing was largely in amplification and reenforcement of that at the original hearing. For convenience, the principal facts shown by the record, as supplemented, will be recapitulated.

The route of applicant's line lies wholly within the State of Illinois and extends in a southwesterly direction from Mount Vernon about 11 miles to a point called Nason, at which a coal mine is being developed. From this point it extends westwardly about 3 miles to a connection with the Chicago, Burlington & Quincy, hereinafter called the Burlington. The annexed map shows the

[1] *Construction of Line by Jefferson Southwestern*, 86 I. C. C. 796 (April 15, 1924).

position of the line in relation to others. It was projected in the interest of the Illinois Coal Corporation, and its principal use will be the transportation of coal for that corporation. It will engage in general transportation service, carrying passengers and express as well as freight, but it is expected that at least 90 per cent of its tonnage will be coal. At the original hearing it was stated that the capacity of the mine at Nason would be 8,000 tons per day, but at the later hearing this figure was advanced to 10,000 tons. It will be an unusually large mine. Two shafts have been sunk, a power house and other mine buildings have been erected, and about 100 houses have already been built upon the town site. There are said to be indications of a continuous body of coal extending along the route from Nason to Mount Vernon, so that additional mines are probable. It was testified that the coal is of superior quality.

The line traverses a farming country of rather low productive capacity. The annual shipments from this region amount to about 40 cars of hay, 26 cars of eggs, and 50,000 pounds of butter fat, moving largely to points outside of Illinois. The route between Mount Vernon and Nason lies along a low ridge and there are creeks on the east and west which overflow in rainy seasons, cutting off communication with the railroads in those directions; but it was also testified that the construction of 1 mile of hard road across either of these creek bottoms would relieve the difficulty. The territory is naturally tributary to Mount Vernon, a city of about 10,000 inhabitants, with which it is connected by highway. The testimony is that about 1,000 people are nearer the new road than to other lines, but it is predicted that a town of perhaps 5,000 inhabitants will soon grow up at Nason, provided interstate transportation is afforded. It is claimed that the Nason mine will employ 1,500 men. Applicant proposes to maintain regular passenger service by the operation of a gasoline-motor car, and to establish three nonagency stations between Mount Vernon and Nason for passengers and prepaid less-than-carload freight.

The new line will connect at Mount Vernon, either directly, or by means of switch tracks, with the Chicago & Eastern Illinois, Louisville & Nashville, Southern, and Wabash, Chester & Western, and at its southwestern extremity with the Burlington. At the time of the rehearing negotiations were in progress for connections with trunk lines at Mount Vernon. The Burlington stated for the record that it is willing to build a spur track from a point on

its railroad near Waltonville, Ill., to Nason, and to provide adequate service thereon, but that it will not construct or operate such a line if obliged to meet the competition of the applicant in interstate commerce. The Chicago & Eastern Illinois and the Wabash, Chester & Western also indicated their willingness to build spur tracks to the new mine. A track about 4 miles in length built from the mine to Waltonville would connect with both the Burlington and the Wabash, Chester & Western. By using the line of the latter connection could be made with other trunk lines at Mount Vernon. It is shown that the bulk of the coal from southern Illinois now moves to the north and northwest to territory reached by the Burlington or by its connections. Mines in this field, as a rule, are served by industrial tracks to the trunk lines, and not by independent short lines. Interveners express the belief that if the applicant is permitted to construct its line and to secure its expected advantages in service and divisions of rates, other coal-producing companies in the southern Illinois field will endeavor to follow its example.

It was shown at the rehearing that soon after our original report the applicant proceeded with the construction of its proposed line and that it has completed the portion from Mount Vernon to Nason, leaving for construction only the 3 miles between Nason and the Burlington. Operation of the line between Mount Vernon and Nason was commenced about October 1, 1923, and has since been continued. Freight, passengers, and express have been carried, but all such transportation is claimed to have been in intrastate commerce. The Illinois Commerce Commission has granted a certificate of convenience and necessity authorizing the construction and operation of the railroad as an intrastate carrier in Illinois, and the validity of the certificate has been upheld by the Supreme Court of Illinois. It appears, also, that the Illinois Coal Corporation had borrowed $3,500,000 in reliance upon the construction of the new line and the shipment of coal from the mine at Nason. The issue of securities by applicant to provide funds for construction has been approved by the Illinois commission, but our approval of such issue has not been sought, although it seems that applicant is a "corporation organized for the purpose of engaging in transportation by railroad subject to" the interstate commerce act. See paragraph (1) of section 20a of that act. The record indicates that the cost of construction to October 1, 1923, including some equipment, was about $426,000, and that it will cost approxi-

mately $100,000 more to build to a connection with the Burlington and about $75,000 to build yard tracks at each terminus.

The fact that the proposed new line of railroad has in part been constructed for use in intrastate commerce has no bearing upon the issue by which we are confronted. It can not properly be permitted to influence our decision. There had been no construction at the time of the original report, and the issue is the same now as it was then. So far as interstate commerce is concerned, the proposed line does not exist.

There seems little disposition to deny that public convenience and necessity require the building by some agency of some line of railroad which will serve the new mine at Nason. The disputed questions are two: (1) Whether such line of railroad should follow the route proposed by applicant, and (2) whether it should be built by applicant.

The first question may be answered by considering the possible alternatives. A spur track from Nason to a connection with the Burlington would be shorter and cheaper, but, unless built to Waltonville, it would afford an outlet over but one railroad. Even if it reached Waltonville this would still be largely true, for the Burlington would hardly permit itself to be short-hauled by turning the traffic over to the Wabash, Chester & Western. The building of a spur track by the Burlington would in all probability be followed by the construction of spur tracks by both the Chicago & Eastern Illinois and the Wabash, Chester & Western. We have on the one hand, therefore, three spur tracks reaching three separate railroads and, on the other hand, the line proposed by the applicant reaching Mount Vernon and a connection with the Burlington.

Applicant's route follows the low ridge between the waterways with no severe grades or curves, and at Mount Vernon it affords connection not only with the Chicago & Eastern Illinois, but with the Southern and the Louisville & Nashville as well, and possibly with the Wabash, Chester & Western. At the other end it connects with the Burlington. Mount Vernon is the largest town in the vicinity and the natural trading center. While the three suggested spur tracks might, in the aggregate, cost somewhat less than applicant's line, although there is no certainty as to such lower cost, switching operations would be multiplied at the mine, trunk-line connections would be less favorable than those afforded by applicant's route, and there would be far less opportunity for

a convenient passenger and express service. We are of the opinion that if some line of railroad is to serve the new mine and the very considerable population which it promises to attract, applicant has selected the best route and the one which will be of maximum public convenience.

The second question is the more difficult, and it raises a very serious issue of public policy. In our original report we said, at page 780:

The Illinois commission has authorized the applicant to issue $700,000 of capital stock of which about $500,000 has been subscribed. Approximately $175,000 thereof was subscribed by the stockholders of the coal company and the remaining subscriptions were procured by its president. The line has been projected and promoted in the interests of the coal company. It was originally intended, as the Illinois commission found, that the interests controlling the coal company would finance the proposed railroad. The promoters concluded, however, that it was best to procure subscriptions from persons not stockholders of the coal company and that has been done to the extent and in the manner stated. Three, at least, of the applicant's five directors are officers and directors of the coal company and the only witnesses appearing in this case as incorporators or directors of the applicant, or as having any pecuniary interest therein, are officers of the coal company.

No facts were developed at the rehearing which make it necessary to modify this statement. The Burlington urges that the proposed interstate transportation of coal by applicant for the Illinois Coal Corporation would be in violation of the commodities clause of the interstate commerce act. This is paragraph (8) of section 1, reading as follows:

From and after May first, nineteen hundred and eight, it shall be unlawful for any railroad company to transport from any State, Territory, or the District of Columbia, to any other State, Territory, or the District of Columbia, or to any foreign country, any article or commodity, other than timber and the manufactured products thereof, manufactured, mined or produced by it, or under its authority, or which it may own in whole or in part, or in which it may have any interest, direct or indirect, except such articles or commodities as may be necessary and intended for its use in the conduct of its business as a common carrier.

It was because of this commodities clause, undoubtedly, that the promoters of applicant concluded "that it was best to procure subscriptions from persons not stockholders of the coal company."

Whether or not they have succeeded in escaping from the clause may be doubted, for its language is very broad and it has been broadly interpreted by the United States Supreme Court. . . .

This brings us to a consideration of some of the reasons underlying the commodities clause and of the reasons which lead the protestants in this case so strongly to oppose the granting of the desired certificate of public convenience and necessity. In our original report we said, at page 782:

> It is evident that the purpose of the promoters is to benefit from competition between the applicant's proposed connections. The president of the applicant and of the coal company, being asked why he wished to build the line, testified that the more transportation a coal mine has, the better off it is. Undoubtedly advantages would be sought in connection with through rates and divisions, absorption of switching charges, and the supply of cars. Indeed the promoters have already entered into negotiations with the trunk lines for favorable arrangements as to these matters.

Control of or affiliation with a short-line railroad by an industry furnishing a large volume of traffic opens the door to grave abuse, particularly when the short line connects with more than one trunk-line railroad. By playing one connection against the other they have frequently been able to gain concessions in divisions, or in car supply, or in other matters, which have, in practical effect, amounted to a preference of, or rebate to, the controlling or affiliated industry. Many such cases have taken our time and attention in the past, and they continually arise. Moreover the connecting trunk lines, because of their competition with each other, often hesitate to bring such cases to our attention, and they have usually been considered either upon our initiative or upon complaint of some industry which is aggrieved by the preference. While the abuse has been limited by our regulation, it is doubtful whether it has been abated. It is not surprising that carriers like the Burlington fear the advent of a short-line industrial railroad in the southern Illinois coal field.

We are not empowered to administer or enforce the commodities clause, but certainly we ought not to grant a certificate of public convenience and necessity for the construction of a railroad whose operation, it seems reasonable to believe, may prove to be in violation of that clause. In our opinion, however, the dangers against which the commodities clause was directed may in this case be avoided by the attachment of a condition to the issuance of the

certificate. Paragraph (20) of section 1 provides that the commission—

> shall have power to issue such certificate as prayed for, or to refuse to issue it, or to issue it for a portion or portions of a line of railroad, or extension thereof, described in the application, or for the partial exercise only of such right or privilege, and *may attach to the issuance of the certificate such terms and conditions as in its judgment the public convenience and necessity may require.* [Italics ours.]

Plainly we are not limited to the mere grant or denial of the certificate sought for, but may shape our action in many intermediate forms to meet the public need.

Railroads like the one here projected, to be built as a single outlet to two or more trunk-line connections, might well be owned, as many urban terminal lines are owned, jointly by such connections. By such ownership the convenience and economy of operation which inhere in one well-located feeder line as compared with two or more separately owned spur-track connections can be retained, and at the same time the dangers of too liberal divisions or other forms of indirect preference to the traffic-furnishing industry can be avoided. Yet inability to agree upon such a plan of joint ownership might hinder or delay the building of such a line, if its construction were left solely to the initiative of the trunk lines. The problem is to combine the initiative of the industry, anxious to obtain at an early date the best possible rail connection with the outside world, with a condition attached to the certificate which will protect the trunk lines and the public against undue exactions.

The problem may be solved, it seems to us, by withholding the issuance of the certificate of convenience and necessity until some valid arrangement has been made and has received our approval under which the Chicago, Burlington & Quincy Railroad Company, the Chicago & Eastern Illinois Railroad Company, the Louisville & Nashville Railroad Company, the Southern Railway Company, and the Wabash, Chester & Western Railroad Company shall have the opportunity at any time within a period of not less than five years, jointly to the extent that they may desire to participate, but severally if but one of said companies wishes to utilize the opportunity, to assume control of the new railroad company by purchasing at par such stock of applicant as may be issued with our approval under section 20a of the interstate commerce act or by leasing its property. This arrangement may take

the form of a declaration of trust or a contract or any other instrument that will lawfully accomplish the result desired and meet with our approval.

Such an arrangement would, in our opinion, go far to eliminate in this case the public dangers against which the commodities clause was directed. Whether it would also, together with the precautions which have been taken by the promoters of applicant, avoid the technical application of that clause is not for us to decide. It is enough to say that it leaves that question in sufficient doubt so that we believe that we are justified in proceeding along the lines indicated.

Upon the facts presented we find that, if and when a valid arrangement of the character above described has received our approval, the present and future public convenience and necessity will require the construction and operation by applicant of the line of railroad in Jefferson County, Ill., described in the application. We further find that the matters of record do not justify the grant of permission to retain excess earnings and such request will be denied.

The proceeding will for the present be held open and an appropriate certificate and order will be entered in the event above specified.

HALL, *Chairman*, dissenting:

The gist of the conclusion reached by the majority seems to be that the present and future public convenience and necessity will require the construction and operation by applicant of the line of railroad described in its application, but only on condition that applicant will bind itself to abdicate in favor of some other common carrier or carriers at any time within five years.

Such a conclusion is self-contradictory. If public convenience and necessity require operation by applicant how can they require surrender of that operation to a would-be lessee, or an option on applicant's stock, at par, to a nonapplicant carrier? It seems to me that if "present and future public convenience and necessity" will not warrant construction and operation by applicant in the absence of such a condition, acceptance of the condition will not supply the defect and the application should be denied. But, as it is, if the condition should prove to be void, because beyond our power to exact, the finding will apparently stand and the certificate must issue.

Aitchison, *Commissioner*, dissenting:

In my opinion the question presented for our decision under the statute is whether the present or future public convenience and necessity require or will require the operation of this line of railway, and that such question should be determined by us without reference to conditions as to what corporation shall own or operate the railway, or whether the owner or operator hereafter may conceivably violate the commodities clause or some other statute. The conditions sought to be imposed by the majority are, in my view of the issue, beyond our power in a proceeding of this character. As the applicant has shown that the public convenience and necessity require and will require the operation of the railway in interstate commerce, as it is now being operated in intrastate commerce by authority of the State of Illinois under a similar statute, a certificate should issue, without conditions, as prayed.

Commissioner Cox authorizes me to state that he joins in this expression of dissent.

2. Divisions of Joint Rates [1]

Mr. Justice Brandeis delivered the opinion of the Court.

Transportation Act 1920, c. 91, § 418, 41 Stat. 456, 486, amending Interstate Commerce Act, § 15 (6), authorizes the Commission, upon complaint or upon its own initiative, to prescribe, after full hearing, the divisions of joint rates among carriers parties to the rate. In determining the divisions, the Commission is directed to give due consideration, among other things, to the importance to the public of the transportation service rendered by the several carriers; to their revenues, taxes, and operating expenses; to the efficiency with which the carriers concerned are operated; to the amount required to pay a fair return on their railway property; to the fact whether a particular carrier is an original, intermediate, or delivering line; and to any other fact which would, ordinarily, without regard to the mileage haul, entitle one carrier to a greater or less proportion than another of the joint rate.

Invoking this power of the Commission, the railroads of New England instituted, in August, 1920, proceedings to secure for themselves larger divisions from the freight moving between that section and the rest of the United States, the joint rates on which had just been increased pursuant to the order entered in *Ex parte*

[1] *The New England Divisions Case*, 261 U. S. 184 (February 19, 1923). See Vanderblue and Burgess, pp. 358–362.

74, Increased Rates, 1920, 58 I. C. C. 220. More than 600 carriers of the United States, mostly railroads, were made respondents. The case was submitted on voluminous evidence. On July 6, 1921, a report was filed. The relief sought was not then granted; but no order was entered. Instead, the parties were directed by the report to proceed individually to readjust their divisional arrangements; and the record was held open for submission of the readjustment; *New England Divisions*, 62 I. C. C. 513. This direction was not acted on. Five months later the case was reargued upon the same evidence. On January 30, 1922, the Commission modified its findings and made an order (amended March 28, 1922) which directed, in substance, that the divisions, or shares, of the several New England railroads in the joint through freight rates be increased 15 per cent. *New England Divisions*, 66 I. C. C. 196. Since it did not increase any rate, it necessarily reduced the aggregate amounts receivable from each rate by carriers operating west of Hudson River. The order was limited to joint class rates and those joint commodity rates which are divided on the same basis as the class rates. It related only to transportation wholly within the United States. It was to continue in force only until further order of the Commission. And it left the door open for correction upon application of any carrier in respect to any rate.

Prior to the effective date of that order, there was in force between each of the New England carriers and substantially each of the railroads operating west of the Hudson, a series of contracts providing for the division of all joint class rates upon the basis of stated percentages. These agreements were in the form of express contracts. Section 208 (b) of Transportation Act, 1920, provided that all divisions of joint rates in effect at the time of its passage should continue in force until thereafter changed either by mutual agreement between the interested carriers or by state or federal authorities. The second report enjoined upon all parties the necessity for proceeding, as expeditiously as possible, with a revision of divisions upon a more logical and systematic basis; made specific suggestions as to the character of the study to be pursued; and invited carriers to present to the Commission any cases of inability to agree upon such revision. No further application was, however, made to the Commission.

In March, 1922, this suit was commenced in the federal court for the Southern District of New York to enjoin enforcement of the order and to have it set aside as void. The Akron, Canton &

Youngstown Railway and forty-three other carriers joined as plaintiffs, suing on behalf of themselves and others similarly situated. The United States alone was named as defendant. But the Interstate Commerce Commission and ten New England carriers intervened as such, and filed answers. The case was then heard, on application for an interlocutory injunction, by three judges under the provisions of Urgent Deficiencies Act, October 22, 1913, c. 32, 38 Stat. 208, 219. The full record of the proceedings before the Commission, including all the evidence, was introduced. The injunction was denied, 282 Fed. 306; and the case is here by direct appeal. Plaintiffs urge six reasons why the order of the Commission should be held void.

First. It is contended that the order is void, because its purpose was not to establish divisions just, reasonable and equitable, as between connecting carriers, but, in the public interest, to relieve the financial needs of the New England lines, so as to keep them in effective operation. The argument is that Congress did not authorize the Commission to exercise its power to accomplish that purpose. An order, regular on its face, may, of course, be set aside if made to accomplish a purpose not authorized. . . . But the order here assailed is not subject to that infirmity.

Transportation Act, 1920, introduced into the federal legislation a new railroad policy. . . . Theretofore, the effort of Congress had been directed mainly to the prevention of abuses; particularly, those arising from excessive or discriminatory rates. The 1920 Act sought to ensure, also, adequate transportation service. That such was its purpose, Congress did not leave to inference. The new purpose was expressed in unequivocal language.[1] And to attain it, new rights, new obligations, new machinery, were created. The new provisions took a wide range.[2] Prominent among them are

[1] Thus: to enable the carriers "properly to meet the transportation needs of the public," § 422, p. 491; to give due consideration to "the transportation needs of the country, * * * and the necessity * * * of enlarging [transportation] facilities," § 422, p. 488; to "best meet the emergency and serve the public interest," § 402, p. 477; to "best promote the service in the interest of the public and the commerce of the people," § 402, pp. 476, 477; "that the public interest will be promoted," § 407, p. 482.

[2] Among them are the establishment of the Railroad Labor and the Adjustment Boards. Title III, pp. 469–474; See *Pennsylvania R. R. Co.* v. *United States Railroad Labor Board, ante,* 72; the provisions for raising capital, by new Government loans, § 210, pp. 468–469, by loans from the Railroad Contingent Fund (the recapture provision), § 15a (10, 16), pp. 490, 491; those placing the issue of new securities under the control of the Commission, unaffected by the laws of the several States, § 439, pp. 494–496; the provision for consolidation of railways into a limited number of systems, § 407, pp. 480–482; provisions for securing adequate car service; *Lambert Run Coal Co.* v. *Baltimore & Ohio R. R. Co.,* 258 U. S. 377; for joint use

those specially designed to secure a fair return on capital devoted to the transportation service.[1] Upon the Commission, new powers were conferred and new duties were imposed.

The credit of the carriers, as a whole, had been seriously impaired. To preserve for the nation substantially the whole transportation system was deemed important. By many railroads funds were needed, not only for improvement and expansion of facilities, but for adequate maintenance. On some, continued operation would be impossible, unless additional revenues were procured. A general rate increase alone would not meet the situation. There was a limit to what the traffic would bear. A 5 per cent. increase had been granted in 1914, *Five Per Cent. Case,* 31 I. C. C. 351; Id., 32 I. C. C. 325; fifteen per cent. in 1917, *Fifteen Per Cent. Case,* 45 I. C. C. 303; twenty-five per cent. in 1918, General Order of Director General, No. 28. Moreover, it was not clear that the people would tolerate greatly increased rates (although no higher than necessary to produce the required revenues of weak lines) if thereby prosperous competitors earned an unreasonably large return upon the value of their properties. The existence of the varying needs of the several lines and of their widely varying earning power was fully realized. It was necessary to avoid unduly burdensome rate increases and yet secure revenues adequate to satisfy the needs of the weak carriers. To accomplish this two new devices were adopted: the group system of rate making and the division of joint rates in the public interest. Through the former, weak roads were to be helped by recapture from prosperous competitors of surplus revenues. Through the latter, the weak were to be helped by preventing needed revenue from passing to prosperous connections. Thus, by marshaling the revenues, partly through capital account, it was planned to distribute augmented earnings, largely in proportion to the carrier's needs. This, it was hoped, would enable the whole transportation system to be maintained, without raising unduly any rate on any line. The pro-

of terminals; for routing; for interchange of traffic between railroads, and between a railroad and water carrier, § 402, pp. 476–478; § 405, p. 479; §§ 412, 413, p. 483.

[1] § 422, pp. 488, 489. To this end, also, the Commission was empowered, among other things, to permit pooling of traffic or earnings, § 407, pp. 480, 481; to authorize abandonment of unprofitable and unnecessary lines, § 402, p. 477; *Texas* v. *Eastern Texas R. R. Co.*, 258 U. S. 204; to fix minimum, as well as maximum, rates; and thus prevent cut-throat competition and the taking away of traffic from weaker competitors, § 418, p. 485; to prevent the depletion of interstate revenues by discriminating intrastate rates, *Railroad Commission of Wisconsin* v. *Chicago, Burlington & Quincy R. R. Co.*, 257 U. S. 563; *New York* v. *United States*, 257 U. S. 591; and to determine the division of joint rates.

vision concerning divisions was, therefore, an integral part of the machinery for distributing the funds expected to be raised by the new rate-fixing sections. It was, indeed, indispensable.

Raising joint rates for the benefit of the weak carriers might be the only feasible method of obtaining currently the needed revenues. Local rates might already be so high that a further increase would kill the local traffic. The through joint rates might be so low that they could be raised without proving burdensome. On the other hand the revenues of connecting carriers might be ample; so that any increase of their earnings from joint rates would be unjustifiable. Where the through traffic would, under those circumstances, bear an increase of the joint rates, it might be proper to raise them, and give to the weak line the whole of the resulting increase in revenue. That, to some extent, may have been the situation in New England, when, in 1920, the Commission was confronted with the duty, under the new § 15a, of raising rates so as to yield a return of substantially 6 per cent. on the value of the property used in the transportation service. *Ex parte 74, Increased Rates, 1920,* 58 I. C. C. 220.

The deficiency in income of the New England lines in 1920 was so great that (even before the raise in wages ordered by the Railroad Labor Board) an increase in freight revenues of 47.40 per cent. was estimated to be necessary to secure to them a fair return. On a like estimate, the increased revenues required to give the same return to carriers in Trunk Line Territory was only 29.76 per cent. and to carriers in Central Freight Association Territory 24.31 per cent. To have raised the additional revenues needed by the New England lines wholly by raising the rates within New England—particularly when rates west of the Hudson were raised much less—might have killed New England traffic. Rates there had already been subjected (besides the three general increases mentioned above) to a special increase, applicable only to New England, of about ten per cent. in 1918. *Proposed Increases in New England,* 49 I. C. C. 421. A further large increase in rates local to New England would, doubtless, have provoked more serious competition from auto trucks and water carriers. For hauls are short and the ocean is near. Instead of erecting New England into a separate rate group, the Commission placed it, with the other two subdivisions of Official Classification Territory, into the Eastern Group; and ordered that freight rates in that group be raised 40 per cent. At that rate level the revenues of the carriers

in Trunk Line and Central Freight Association territories would, it was asserted, exceed by 1.48 per cent. what they would have received if they had been a separate group. It was estimated that the excess would be about $25,000,000. Substantially that amount (besides the additional revenue to be raised otherwise) was said to be necessary to meet the needs of the New England lines.

Plaintiffs insist that Transportation Act, 1920, did not, by its amendment of § 15 (6) change, or add to, the factors to be considered by the Commission in passing upon divisions; that it had, theretofore, been the Commission's practice to consider all the factors enumerated in § 15 (6); that this enumeration merely put into statutory form the interpretation theretofore adopted; that the only new feature was the grant of authority to enter upon the inquiry into divisions on the Commission's initiative; that this authority was conferred in order to protect the short lines, which, because of their weakness, might refrain from making complaint, for fear of giving offence; and that the power conferred upon the Commission is coextensive only with the duty imposed on the carriers by § 400 of Transportation Act, 1920, which declares that they shall establish "in case of joint rates * * * just, reasonable, and equitable divisions thereof as between the carriers subject to this Act participating therein which shall not unduly prefer or prejudice any of such participating carriers." It is true that § 12 of the Act of June 18, 1910, c. 309, 36 Stat. 539, 551, 552, which first conferred upon the Commission authority to establish or adjust divisions, did not, in terms, confer upon the Commission power to act on its own initiative. The language of the act seemed to indicate that the authority was to be exercised only when the parties failed to agree among themselves, and only in supplement to some order fixing the rates. The extent of the Commission's power was a subject of doubt, and Transportation Act, 1920, undertook by § 15 (6) to remove doubts which had arisen. But Congress had, also, the broader purpose explained above. This is indicated, among other things, by expressions used in dealing with joint rates. By new § 15 (6), p. 486, the Commission is directed to give due consideration, in determining divisions, to "the importance to the public of the transportation services of such carriers;" just as by new § 15 (3), page 485, the Commission is authorized upon its own initiative when "desirable in the public interest" to establish joint rates and "the divisions of such rates."

Second. It is contended that if the act be construed as authorizing such apportionment of a joint rate on the basis of the greater needs of particular carriers it is unconstitutional. There is no claim that the apportionment results in confiscatory rates, nor is there in this record any basis for such a contention. The argument is that the division of a joint rate is essentially a partition of property; that the rate must be divided on the basis of the services rendered by the several carriers; that there is no difference between taking part of one's just share of a joint rate and taking from a carrier part of the cash in its treasury; and, thus, that apportionment according to needs is a taking of property without due process. But the argument begs the question. What is its just share?—It is the amount properly apportioned out of the joint rate. That amount is to be determined, not by an agreement of the parties or by mileage. It is to be fixed by the Commission; fixed at what that board finds to be just, reasonable and equitable. Cost of the service is one of the elements in rate making. It may be just to give the prosperous carrier a smaller proportion of the increased rate than of the original rate. Whether the rate is reasonable may depend largely upon the disposition which is to be made of the revenues derived therefrom.

What the Commission did was to raise the additional revenues needed by the New England lines, in part, directly, through increase of all rates 40 per cent. and, in part, indirectly, through increasing their divisions on joint rates. In other words, the additional revenues needed were raised partly by a direct, partly by an indirect tax. It is not true, as argued, that the order compels the strong railroads to support the weak. No part of the revenues needed by the New England lines is paid by the western carriers. All is paid by the community pursuant to the single rate increase ordered in *Ex parte 74*. If, by a single order, the Commission had raised joint rates throughout the Eastern Group 40 per cent., and, in the same order, had declared that 90 per cent. of the whole increase in the joint rates should go to the New England lines (in addition to what they would receive under existing divisions), clearly nothing would have been taken from the Trunk Line and Central Freight Association carriers, in so ordering. The order entered in *Ex parte 74* was at all times subject to change. The special needs of the New England lines were at all times before the Commission. That these needs were met by two orders instead of one, is not of legal significance. The order here in question may

properly be deemed a supplement to, or modification of, that entered in *Ex parte 74*.

Third. It is asserted that the order is necessarily based upon the theory that, under § 15 (6), the Commission has authority to fix divisions as between groups of carriers without considering the carriers individually; that Congress did not confer such authority; and that, hence, the order is void. Whether Congress did confer that authority we have no occasion to consider; for it is clear that the Commission did not base its order upon any such theory. The order directs a 15 per cent. increase in the divisions to the several New England lines. It is comprehensive. But it is based upon evidence which the Commission assumed was typical in character, and ample in quantity, to justify the finding made in respect to each division of each rate of every carrier. Whether the assumption was well founded will be discussed later. Here we are to consider merely, whether Congress authorized the method of proof and of adjudication pursued, and whether it could authorize it, consistently with the Constitution.

Obviously, Congress intended that a method should be pursued by which the task, which it imposed upon the Commission, could be performed. The number of carriers which might be affected by an order of the Commission, if the power granted were to be exercised fully, might far exceed six hundred; the number of rates involved, many millions. The weak roads were many. The need to be met was urgent. To require specific evidence, and separate adjudication, in respect to each division of each rate of each carrier, would be tantamount to denying the possibility of granting relief. We must assume that Congress knew this; and that it knew also that the Commission had been confronted with similar situations in the past and how it had dealt with them.

For many years before the enactment of Transportation Act, 1920, it had been necessary, from time to time, to adjudicate comprehensively upon substantially all rates in a large territory. When such rate changes were applied for, the Commission made them by a single order, and, in large part, on evidence deemed typical of the whole rate structure. This remained a common practice after the burden of proof to show that a proposed increase of any rate was reasonable had been declared, by Act of June 18, 1910, c. 309, § 12, 36 Stat. 539, 551, 552, to be upon the carrier. Thus, the practice did not have its origin in the group system of rate making provided for in 1920 by the new § 15 (a). It was the actual neces-

sities of procedure and administration which had led to the adoption of that method, in passing upon the reasonableness of proposed rate increases. The necessity of adopting a similar course when multitudes of divisions were to be passed upon was obvious. The method was equally appropriate in such enquiries; and we must assume that Congress intended to confer upon the Commission power to pursue it.

That there is no constitutional obstacle to the adoption of the method pursued is clear. Congress may, consistently with the due process clause, create rebuttable presumptions. . . . It might, therefore, have declared in terms, that if the Commission finds that evidence introduced is typical of traffic and operating conditions, and of the joint rates and divisions, of the carriers of a group, it may be accepted as *prima facie* evidence bearing upon the proper divisions of each joint rate of every carrier in that group. Congress did so provide, in effect, when it imposed upon the Commission the duty of determining the divisions. For only in that way could the task be performed. As pointed out in *Railroad Commission of Wisconsin* v. *Chicago, Burlington & Quincy R. R. Co.*, 257 U. S. 563, 579, serious injustice to any carrier could be avoided, by availing of the saving clause which allows anyone to except itself from the order, in whole or in part, on proper showing.

Fourth. It is asserted that the order directs a transfer of revenues of the western carriers to the New England carriers, pending a decision in the matter of divisions; that Congress has not granted authority to take such provisional action; and that, hence, the order is void. The argument is, that under § 15 (6), the Commission may prescribe divisions only when, upon full hearing, it is of opinion that those existing are, or will be, unjust, unreasonable or inequitable; that in such event it shall prescribe divisions which are just, reasonable and equitable; and that the provisional character of the order demonstrates that the hearing has not been a full one. Whether a hearing was full, must be determined by the character of the hearing, not by that of the order entered thereon. A full hearing is one in which ample opportunity is afforded to all parties to make, by evidence and argument, a showing fairly adequate to establish the propriety or impropriety, from the standpoint of justice and law, of the step asked to be taken. The Commission recognized, and observed, these essentials of a full hearing.

The complaint before it was filed in August, 1920. The hearings

did not begin until December 15, 1920. The parties had, therefore, ample time to prepare to present their evidence and arguments. The case was not submitted until April 23, 1921. There was thus ample time for, and every carrier was, in fact, afforded the opportunity of, introducing any and all evidence it desired. The record made is voluminous. That the evidence left in the minds of the Commission many doubts, is true. But it had brought conviction that the New England lines were entitled to relief; that the divisional arrangements of the carriers required a thorough revision to put them upon a more logical and systematic basis; that a horizontal increase of the New England lines' divisions, made before such revision, would leave some divisions too high and others too low; that the comprehensive revision proposed would necessarily take a long time; and that, meanwhile, the New England lines should be accorded "a portion of the relief to which * * * they are entitled and which the public interest clearly requires." The Commission further concluded that, on the evidence before it, no substantial injustice would be done to the carriers west of the Hudson by an order which increased by 15 per cent. the existing divisions of the New England lines, and reduced, by the amount required for this purpose, the divisions of the several carriers west of the Hudson, in the proportions in which they then shared the balance of each joint rate; or as otherwise might be agreed between them or determined by the Commission upon application.

A hearing may be a full one, although the evidence introduced does not enable the tribunal to dispose of the issues completely or permanently; and although the tribunal is convinced, when entering the order thereon, that, upon further investigation, some changes in it will have to be made. To grant under such circumstances immediate relief, subject to later readjustments, was no more a transfer of revenues pending a decision, than was the like action, in cases involving general increases in rates, a transfer of revenues from the pockets of the shippers to the treasury of the carriers. That the order is not obnoxious to the due process clause, because provisional, is clear. If this were not so, most temporary injunctions would violate the Constitution.

Fifth. It is contended that the order is void, because it confines itself to dealing with the main, or primary, divisions of the joint rates at the Hudson River and fails to prescribe the subdivisions of that part of the rate which goes to the several carriers. The argument is, that if the Commission acts at all in apportioning the

joint rate, its action is invalid unless it prescribes the proportion to be received by each of the connecting carriers. For this contention there is no warrant either in the language of the act, in the practice of carriers, or in reason. The duty imposed upon the Commission does not extend beyond the need for its action. If the real controversy is merely how much of the joint rate shall go to carriers east of Hudson River and how much to carriers west, there is nothing in the law which prevents the Commission from letting the parties east of the river, and likewise those west of it, apportion their respective shares among themselves. It is obviously of no interest to the western carriers how those of New England decide to apportion their share; nor is it of interest to the eastern carriers how those west of the Hudson divide the share apportioned to that territory. If on these matters the carriers interested can reach an agreement and no public interest is prejudiced, clearly, there is no occasion for the Commission to act.

But there is a further answer to this contention. The Commission has fixed the subdivisions east and also those west of the River. The divisions of the several New England lines are definitely fixed; for the amount receivable by each carrier from each joint rate is ordered increased fifteen per cent. What remains of each joint rate goes to the western lines. This balance, the order recites, shall be divided among them "in the same proportions as at present, or otherwise as they may agree, or failing such agreement, as may be determined by the Commission upon application therefor." That fixes the divisions by reference. The fact that they are fixed provisionally and by reference, does not invalidate the order. It is urged that this disposition demonstrates failure by the Commission to consider the several factors which the statute declares shall be taken into consideration in determining divisions. But this is not true. This feature in the order indicates rather that the Commission has considered the question; concluded that the apportionment by the western lines of their share on existing proportions, was not inconsistent with the public interest; and that, in the absence of complaint, it might be assumed to be satisfactory to all parties. This objection presents in a different form largely what has been more fully discussed above. There was, thus, on the part of the Commission neither usurpation of power, nor neglect of duty, in limiting its definite decision to the primary divisions at the Hudson River gateways, and leaving the interested

parties to deal, in the first instance, with the subdivisions among the carriers in their respective territories.

Sixth. It is contended that the order is void, because it is unsupported by evidence. An order of the Commission fixing rates, if unsupported by evidence, is clearly invalid. . . . The rule must, of course, be the same in respect to an order fixing divisions. The contention that the order is unsupported by the evidence rests largely upon arguments which assume a construction of the statute which we hold to be erroneous, or upon expressions in the first report of the Commission, which, in view of the second report and order thereon, must be deemed to have been withdrawn. That the evidence was ample to support the order made, is shown in the opinion of the lower court, 282 Fed. 306, 308, 309, and in the reports of the Commission. To consider the weight of the evidence, or the wisdom of the order entered, is beyond our province. . . . But the way is still open to any carrier to apply to the Commission for modification of the order, if it is believed to operate unjustly in any respect.

Affirmed.

3. Leases [1]

By the Commission:

The Pennsylvania Railroad Company, a common carrier by railroad subject to the interstate commerce act, herein after called the Pennsylvania, on June 2, 1921, filed an application, pursuant to paragraph (2) of section 5 of the interstate commerce act, for an order authorizing it to acquire control, by lease, of the railroad and leased lines of the Pittsburgh, Cincinnati, Chicago & St. Louis Railroad Company, a common carrier by railroad subject to the interstate commerce act, hereinafter called the Pan Handle, for the term of 999 years from January 1, 1921. Hearings were held upon this application on September 27 and December 13, 1921. No representations were made by any State authority either in favor of or against the granting of the application. The application was made the subject of a tentative report by an examiner, to which report exceptions were filed by interveners, and the case was argued orally by the parties.

At the first hearing the Continental Insurance Company, hereinafter called the Continental Company, filed an intervening peti-

[1] *Lease of Pan Handle by Pennsylvania Railroad,* 72 I. C. C. 128 (July 10, 1922). See Vanderblue and Burgess, pp. 369–370, and Jones, pp. 330–332, 596.

tion asking that the application be denied on the ground that the proposed lease is unfair and unjust to the independent stockholders of the Pan Handle, or "in the event that the Commission deems it in the public interest that such lease be authorized, then that such authorization shall be upon the condition that the Pennsylvania Railroad Company pay an adequate and just consideration, equal to a dividend of 6¾ per cent upon the outstanding stock of the Pittsburgh, Cincinnati, Chicago & St. Louis Railroad Company, and that the terms of the lease shall secure to such stockholders a return in that amount."

At the second hearing it was contended in behalf of L. Kemp Duval, an intervening minority stockholder owning 1,225 shares of the capital stock of the Pan Handle, that not only should the past earnings for a period of not less than 10 years be considered, but that in determining what those earnings were, we can not accept the earnings credited to the Pan Handle by the board of directors or other officials of that company as being the true earnings, but that we should, through our own examiners, make an investigation and ascertain what the true earnings were.

The Pan Handle was organized January 1, 1917, as a consolidation of the Pittsburgh, Cincinnati, Chicago & St. Louis Railway Company, the Vandalia Railroad Company, the Pittsburgh, Wheeling & Kentucky Railroad Company, the Anderson Belt Railway Company, and the Chicago, Indiana & Eastern Railway Company. Its railroad extends from Pittsburgh, Pa., to Cincinnati, Ohio, Chicago, Ill., Louisville, Ky., and St. Louis, Mo., and serves many cities of importance in the intervening territory. It operates 2,265.61 miles of first main track, of which 1,855.38 miles are owned by it and 410.23 miles are leased.

By the terms of the proposed lease, the Pan Handle demises to the Pennsylvania all the railroads owned and operated by it, and assigns to the Pennsylvania the leases which it holds of the Little Miami Railroad, extending from Cincinnati, Ohio, to Columbus, Ohio, and Richmond, Ind.; the Terre Haute & Peoria Railroad, extending from Farmdale, Ill., to Maroa, Ill., and from Decatur Junction, Ill., to the Indiana State line near Farrington, Ill.; and that portion of the Evansville & Terre Haute Railroad extending from Terre Haute, Ind., to Rockville, Ind. By the terms of the lease the Pennsylvania proposes to pay to the Pan Handle, as rental (*a*) a sum equivalent to 4 per cent per annum on the Pan Handle's now outstanding capital stock until December

31, 1925, and 5 per cent per annum thereafter, without deduction for any taxes other than an income tax on the stockholder levied by the Government of the United States; also a sum equivalent to such percentage on any additional capital stock that may with the approval of the lessee be issued by the lessor after January 1, 1921, as shall have been agreed upon by the lessor and the lessee at or prior to the date of the issuance thereof. The lease provides that it is—

the true intent and meaning of these presents that the said sum shall at all times hereafter be and remain applicable to and be applied and disbursed by the lessor as a dividend fund for its stockholders, when and as from time to time received as herein provided, without any deduction or abatement on account of any such taxes, and that every such tax shall be paid by the lessee in addition thereto, except as income tax on the stockholder levied by the Government of the United States above referred to.

(*b*) A further sum sufficient to enable the Pan Handle to maintain its corporate organization and to pay all taxes and assessments and all installments of interest and sinking funds on its bonded and other indebtedness, when due and payable, and all taxes in respect of such bonded or other indebtedness.

The Pennsylvania further agrees to pay all rentals accruing under the leases of the Little Miami Railroad and the Terre Haute & Peoria Railroad, hereinabove referred to, and all sums to become due under any contracts for trackage or other rights conferred upon or possessed by the Pan Handle. The lease further provides that the Pennsylvania may and will make all such improvements, betterments, and additions to the demised premises as shall in its judgment be necessary, and that the cost thereof shall be repaid to it by the Pan Handle, either in money, or by the issue and delivery to it of bonds of the Pan Handle, or of its capital stock, as the Pennsylvania shall elect. Upon the maturity of any of its bonds during the term of the lease, the Pan Handle, if unable to pay them, agrees to provide for their extension, or to issue and deliver to the Pennsylvania other bonds to provide for such payment.

On March 15, 1920, the Pennsylvania Company, a corporation whose entire capital stock is held by the Pennsylvania, owned 651,245 shares of the capital stock of the Pan Handle and the Pennsylvania owned 4,500 shares. These holdings aggregated 77.54 per cent of the entire capital stock. The remainder of the stock, amounting to 189,908 shares, was held by outside stockholders.

For many years the Pennsylvania Company and the Pennsylvania have been the financial backers of the Pan Handle and its predecessor companies. Either one or the other of these two companies has guaranteed all the outstanding bonds of the Pan Handle and has advanced funds from time to time to enable it to enlarge and improve its property, to provide equipment, and to sustain its credit. On March 15, 1920, the Pan Handle was indebted to the Pennsylvania Company for advances to an amount approximating $22,000,000, and thereafter issued and delivered to the Pennsylvania Company $20,000,000 of its 5 per cent 50-year bonds to discharge this indebtedness. Thereupon the Pennsylvania Company offered to purchase the outstanding minority stock of the Pan Handle by paying to the holders thereof, par for par, 50-year 5 per cent bonds of the Pan Handle, guaranteed, principal and interest, by the Pennsylvania. This offer was accepted by the holders of 174,791 shares. There remain outstanding 15,117 shares of minority stock, comprising 1.7 per cent of the total issue, of which the Continental Company owns 2,000 shares. The shares held by the Continental Company were the only shares that voted against the approval of the proposed lease.

For many years the Pan Handle and the Pennsylvania have worked in close cooperation and have interchanged and moved traffic as one transportation system. It is stated by the applicant that the proposed lease will enable it to operate the railroad of the Pan Handle as a part of its system, which will eliminate much of the separate accounting now necessary. It is expected that economies in operation will be effected through a better alignment of operating divisions and the reduction of overhead expenses. It should also simplify the work of preparing reports required by Federal and State regulatory bodies.

At the close of the year 1920, the Pan Handle had an authorized capital stock of $100,000,000, of which $84,701,957.50 was issued and outstanding. In addition thereto there was a stock liability for conversion amounting to $158,153.58. Its authorized funded debt, including equipment obligations, amounted to $140,471,818, of which $106,467,512 was outstanding. The road-and-equipment account showed an investment of $260,750,063.55, and the profit-and-loss credit balance amounted to $4,558,261.44. The Continental Company states that the physical value of the Pan Handle property, as indicated by the engineering and land reports of our Bureau of Valuation as of June 30, 1916, plus the net charges to

road and equipment accounts from that date to December 31, 1920, amount to the sum of $221,722,834. No complete tentative valuation of the property has been made by us.

The interveners do not contend that the proposed lease would not be advantageous to the railroad companies involved nor that it would not effect economies beneficial to the public. They do contend, however, that the net income of the Pan Handle for the years 1908 to 1917, inclusive, before deducting payments required to be made to sinking funds, averaged 6.75 per cent on its outstanding capital stock. They contend further that the principal factor in determining the value of the capital stock of a railroad company is the prospect of future earnings of the company, and that the circumstance that the stock of the Pan Handle is virtually guaranteed by the Pennsylvania should not be given any appreciable weight in determining its value. For obvious reasons, the earnings for the period 1908 to 1917 can not be taken as an index of future earnings. A vice president of the Pennsylvania testified that in his opinion there was no hope that the Pan Handle would earn a return equal to 4 per cent on its capital stock during the next five years, even with all economies that might be effected. As to the value of the guaranty, it is common knowledge that in many cases a guaranteed stock may sell on an interest basis comparable to that of bonds. Furthermore, in comparing the value of a rental with a return through dividends, it must be taken into consideration that dividends are not ordinarily measured by net income, but are usually and properly much less.

The interveners contend further that the lease does not expressly provide for the guaranteed dividend; that in this respect it is subject to interpretation; and that the provision in question may very well be held not to be one which can be taken advantage of by the stockholders of the Pan Handle. The vice president of the Pennsylvania testified that it was his understanding that under a fair construction of the lease it is obligatory upon the Pan Handle to disburse as dividends to its stockholders the rental payments of 4 per cent per annum on its capital stock for the first five years and 5 per cent per annum thereafter. The interveners contend also that inasmuch as the Pennsylvania is the majority stockholder of the Pan Handle, has elected its directors, and has controlled the company and operated its property for many years, the two corporations can not be said to be dealing at arm's length, but that the Pennsylvania occupies with respect to the transaction a fidu-

ciary relation to the Pan Handle and to its dissenting stockholders.

We do not consider it necessary to discuss our responsibility in protecting the interests of minority stockholders who may object to proposed action on the part of a carrier corporation, inasmuch as it is our view that the granting of the authority herein requested will not be inimical to the interests of any of the interested stockholders.

As heretofore stated, approximately 98 per cent of the Pan Handle stock is owned by the Pennsylvania and the Pennsylvania Company. It is obvious that so long as that situation continues, the payment of the rentals reserved in the lease will be merely a matter of bookkeeping as regards the 98 per cent of the stock which is so owned. If the Pennsylvania were to dispose of the stock which it and the Pennsylvania Company now hold, an entirely different situation would be presented and one which might very well be said to be against the public interest. Such a sale of stock would separate the responsibility in operating the property under the lease from the proprietorship in the property which is now vested in the lessee. The Pennsylvania contends that we have no power to guard against such an occurrence by means of a condition attached to our authorization which would prevent the Pennsylvania from disposing of the stock without our consent, its position being that the conditions referred to in paragraph (2) of section 5 of the act are the conditions of the lease itself, and that the language does not cover a condition subsequent which is unrelated to the subject matter of the transaction.

We are unable to accept this construction of the law. In considering the propriety of proposed action for which our authority is sought, it is plainly our duty to take into consideration all surrounding circumstances that have a bearing upon the interest of the public in the things sought to be done. It follows, in our opinion, that where the authorization depends for its justification upon certain existing circumstances, the authority given may be conditioned upon a continuance of the controlling circumstances, and proper provisions may be made to insure such continuance, or the substitution of circumstances as satisfactory from the standpoint of the public interest. . . . In this case, we regard the relationship between lessor and lessee as essential to our approval of the proposed arrangement, and such approval will be given upon condition that the Pennsylvania Company and the Penn-

sylvania Railroad Company shall not dispose of their stock in the Pan Handle without our consent. Subject to the aforesaid condition, we find that the acquisition by the Pennsylvania of control of the railroad and leased lines of the Pan Handle under the terms of the lease described in the application will be in the public interest.

An order will be entered accordingly.

POTTER, *Commissioner*, concurring:

Our proper function is limited to an approval or disapproval, in whole or in part, of the proposed acquisition covered by the application before us. We possess no power to require the establishment, by contract or otherwise, of a relation between the acquiring carrier and this commission, by virtue of which we may say what the carrier may or may not do in the future. We may not exact tribute from a carrier as an inducement to us to grant approval. We may not, as a condition, require that a carrier part with any of its property or surrender any of its existing rights. We could not properly demand that the applicant surrender to us its Pan Handle stock. Nor should we demand control of that stock by tying it up so that it can not be used without our consent. And yet this is exactly what the report attempts to do when it says the Pennsylvania may acquire the Pan Handle by lease only upon the condition that it surrender control of an important asset which it now owns and give to us the power of saying how it shall be used during 999 years.

There is much that can happen within 999 years. This commission may not be in existence that long. Notwithstanding our order, the Pennsylvania might in the future go ahead and sell the stock without coming to us. It may be sold under a decree of court at the instance of a creditor. The condition would not prevent these and many other events. Certainly it could not be said that we are empowered to destroy the value of the Pan Handle stock as property, although such is really the logic of the condition imposed. The stock in question is property, and will continue to be property, and the title and power of sale remains with the Pennsylvania. Would its sale constitute a breach of a contract made with us, and, if so, would the remedy be to recover damages, and how and to what extent would we have been damaged? We have no authority to build up such a right for the Government. Would the lease automatically terminate and the property revert

to the Pan Handle? Clearly not. Would a breach of the condition which we have exacted give the Pan Handle the right to reenter and take its property? If we thought we secured that right to the Pan Handle and it did not want to exercise the right, there apparently would be nothing that we could do. But the Pan Handle could not have any such right. It would have agreed otherwise. The condition simply is not workable.

The condition is inherently unwise and unreasonable. If effective, it is a destruction and waste of which we ought not to be guilty. Our job is to develop financial strength, not dissipate it. We should conserve assets for credit and other purposes and not render them unavailable. A lease without condition would vastly improve and strengthen the position of both carrier properties and serve the public interest. The condition, if valid, will injure the carrier and the public. In imposing such a condition we transgress our duty rather than perform it. We prejudice where we should benefit. The Pennsylvania now has a practical control through stock ownership of the Pan Handle. The continuance of that control we find to be desirable, and obviously it is. The Pennsylvania could part with the Pan Handle stock and could hypothecate and otherwise use it. It is available to serve the public interest for credit purposes, but with the present relations between the companies such use might disrupt the system. Allow the lease to be made without condition and the stock could be used no more freely than now, but if through any adversity the stock should get out of Pennsylvania control the system would not be disrupted as would result from a sale of the stock without a lease. The public interest clearly requires that the lease should be made and that the stock should remain available for use as now. It can not be in the public interest to render unavailable an available $50,000,000 asset.

We say it is a good thing to put the properties together. We do not even say that the stock ought not to be sold. We recognize that perhaps it should be sold—but only with our consent. We say the Pennsylvania may acquire the Pan Handle by lease *if* it will turn over to us the right to say whether an asset consisting of shares of stock shall be continued in its present form for 999 years or be converted into something else. To my mind this is an invasion in management in the field of company policy which has not been authorized and which properly was withheld from a governmental agency.

Paragraph (2) of section 5 authorizes us to ascertain whether

the terms and conditions of the lease or other instrument of acquisition are just and reasonable. Such an instrument necessarily must have terms and conditions. The terms and conditions contained in such an instrument presented by the application, and only those so contained, are the ones we are authorized to consider. The purpose is to give us power to determine whether the terms and conditions are unduly burdensome. There is no warrant in the statute for imposing any outside or new conditions establishing a right in us or a relation between the applicant and us as an inducement to us to act.

The explanation of my vote in favor of the report containing the offensive condition is this: Perhaps the applicant will desire to proceed under the report. The application has been before us for a long time. Bad as I think is the report, it seems to be the only way by which the applicant can obtain what I conceive to be even partial justice. Perhaps the applicant will conclude that the condition is illegal, as I am strongly inclined to think it is, and that it may be disregarded, as seems to me it may. Whatever we may think of our power, we are not above the law. The courts may intervene in a helpful way. And then, too, it may be that some time within 999 years this commission will be composed of men whose views do not accord with ours. Perhaps other men at another time will correct our error. I even indulge the hope that with further consideration we may change our mind. The report is no worse than a denial and it may be helpful to have our views understood. So I vote for the report in its present form rather than for a denial. COMMISSIONERS LEWIS and COX concur in these views.

HALL, *Commissioner*, dissenting:

The only justification for my concurrence in this report would be that the condition imposed is as void as it is futile. I prefer to dissent because I am not in accord with the statement of facts, the reasoning, or the conclusion. Incidentally, I fail to perceive why public interest requires that the tenant should be, beneficially, the landlord as well throughout this term. Back of all that lies the belief that no man is wise enough to pass on the sufficiency of provisions in a railroad lease framed to cover a futuie of 999 years. No such period in the past affords any guide. Even 100 years ago steam railroads were unknown, and 200 years hence they may have followed the ox team, or become transformed almost beyond

recognition. Such leases are anachronisms at best and, under section 5 of the interstate commerce act, they are not needed for any purpose. Obviously the parties to this lease are concerned with the immediate rather than the remote future. Perhaps they might better attain their end by seeking approval of a short-term lease pending such consolidation as may become possible under the existing statute. Be that as it may, the present application should either be granted or denied on its merits, without extraneous and continuing condition.

DANIELS, *Commissioner*, dissenting:

The report in this case says:

> * * * we regard the relationship between lessor and lessee as essential to our approval of the proposed arrangement, and such approval will be given upon condition that the Pennsylvania Company and the Pennsylvania Railroad Company shall not dispose of their stock in the Pan Handle without our consent.

Subject to the applicant's acceptance of the aforesaid condition, the applicant's acquisition of control of the Pan Handle under the terms of the proposed lease is found to be in the public interest and approved.

I am not disposed to narrow or restrict the commission's power to prescribe all proper conditions with which to hedge about the acquisition by one carrier of the control over another by means of a lease. I do not assent to the proposition that when such a lease is tendered to us for approval, we are simply to approve or reject *in toto*. Section 5, paragraph (2), is so worded that it is not easy to circumscribe within a ring-fence definition the exact powers which the commission may or may not exercise in the premises. It is not necessary to do so here, beyond saying that any condition imposed by us must be germane to the subject matter of the transaction. The possible future sale or pledge of the capital stock of the Pan Handle is not even remotely connected with the manner in which the proposed control by lease is sought to be acquired. What the imposition of the proposed condition amounts to is to suggest a sort of treaty with the applicant whereby we assume the rôle of guardian of the public interest, and agree that if the applicant and a subsidiary of the applicant will stipulate that what is now a free asset in their corporate treasuries shall in future be subjected to our suspensive vote as to its disposition, we will authorize the applicant to acquire the desired

control of the Pan Handle. I do not believe such a condition falls within the powers we may legitimately exercise under the statute. We may not, under guise of a latitudinarian interpretation of the public interest, exercise jurisdiction over a subject matter of an alien kind in no way connected with the terms or the manner in which the desired control is sought to be obtained. We might with equal propriety prescribe as a condition of our approval that any future bond issues of the Pan Handle shall be marketed through competitive bidding rather than underwritten by a banking house. However excellent the reasons that we might now give for this last-mentioned requirement, the sale in question has nothing to do with the control here sought. Neither has the future method which the applicant may employ in handling what is now a free asset in its treasury, and which we here seek by indirection to subjugate to an extralegal yoke of our own devising.

EASTMAN, *Commissioner,* dissenting:

In this case, the Pennsylvania is seeking authority to acquire control, by lease for a term of 999 years, of the Pan Handle, which operates 2,265 miles of main track and has about $85,000,000 of stock outstanding, nearly all of which is owned by the Pennsylvania or by its subsidiary holding company, the Pennsylvania Company. The rental is to be sufficient to pay 4 per cent per annum upon the stock until 1926 and 5 per cent thereafter.

Experience has shown very clearly the infirmities and dangers of this method of combining railroad properties. They are illustrated by the following from the *New England Investigation,* 27 I. C. C. 560, 600:

During the year 1912 the Boston & Maine operated 2,244 miles of railroad, of which it owned 725 miles, the remainder, 1,519 miles, being leased. In all cases, the rental is a fixed amount. Sometimes the lease provides for the payment of a given sum in cash, but usually the agreement is to pay the interest upon the funded debt of the lessor company and a given per cent upon its capital stock. In most cases it is provided that the lessor company shall issue new securities either stock or bonds, for necessary improvements, although in one or two cases such improvements must be made by the Boston & Maine at its own expense. It will be seen, therefore, that the amount of the rental for these leased roads is a fixed sum which only varies from year to year in the event of change in the funded debt or the stock of the lessor company.

This method of building up a railroad system is inherently a

vicious one. In the first place, it concentrates too much power in too small a stock holding. In 1901 the operated mileage being substantially what it is to-day, the outstanding capital stock of the Boston & Maine was only about $26,500,000; the possession of slightly over $13,000,000 of this stock insured the control over more than 3,000 miles of railway, including the Maine Central. In 1907 the New Haven Company, by the purchase of less than $11,000,000 of this stock, obtained what amounted to a control of the property. This ought not to be possible. The control of a railroad should properly rest with the owners of the property, which is not at all the case with a system constructed as is the Boston & Maine.

The second, and perhaps more serious objection, is this: The margin between fixed charges and income is too narrow. The stipulated rent must be paid, and the interest of the lessee company must also be paid. This item of rent in case of the Boston & Maine slightly exceeds $5,000,000 annually, and its interest charges are something over $2,000,000 annually, while a dividend of 6 per cent upon its outstanding capital stock would be only about $2,500,000. There is in a system built up like this no power of resistance, no working capital, so to speak. The stockholders of the Boston & Maine are little more than residuary legatees of the railroad operations of northern New England. In days of prosperity handsome dividends are enjoyed, but a comparatively slight wave of adversity obliterates these dividends and makes bankrupt the company.

The situation thus described was one of the chief causes of the subsequent receivership. In the reorganization which followed, in 1919, it was found necessary to consolidate the leased lines with the Boston & Maine, and to substitute its preferred stock for their guaranteed shares. There have been many other cases where leases have been a potent contributing cause to the financial downfall of railroad or public utility properties.

Financiers have repeatedly and most forcefully enlarged upon the dangers of increasing the fixed charges of railroad companies in an amount disproportionate to the outstanding capital stock. Our records are full of such admonitions. Certain States prohibit investment by savings banks in the bonds of railroad companies where the ratio between bonds and stocks is greater than 3 to 1. Many financiers think that even this ratio is not sufficiently conservative, and by the railroad laws of Massachusetts the limit is made 2 to 1. Yet every lease which guarantees a fixed return upon stock is equivalent to the substitution of bonds for stock, since it has a similar effect in adding to the burden of fixed charges.

For the above reasons I should have no hesitation in condemning

the proposed lease if the bulk of the Pan Handle stock were not held, directly or indirectly, by the Pennsylvania. Its possession of this stock, in my opinion, is the one factor that renders this lease worthy of consideration, for so long as the stock is so held the return guaranteed comes back to the treasury of the Pennsylvania and has only bookkeeping importance. In passing upon the lease it is entirely proper, therefore, that we should consider whether or not the continuation of this stock ownership is, or can be, assured.

This leads to a further thought. Under section 20a of the interstate commerce act the Pennsylvania may not now issue any share of stock or any bond without our consent, and we may grant such authority only if we find that such issuance—

> (*a*) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (*b*) is reasonably necessary and appropriate for such purpose.

The effect of the 999-year lease which is now proposed would clearly be to make the shares of Pan Handle stock which are now held, directly or indirectly, by the Pennsylvania the equivalent of its own interest-bearing securities. Moreover, while it may not sell its own securities without our consent, it could sell these equivalent guaranteed shares regardless of our supervision and without the finding which section 20a requires. Thus the purpose of this section, which is not only to prevent overcapitalization but to control and regulate the expenditure of capital funds, would be defeated.

I am quite aware that the law does not entirely close the door against the expenditure of capital funds without public supervision, for no supervision is provided where the funds are obtained from surplus earnings or the sale of assets. But we can at least refrain from opening the door wider by permitting a carrier unconditionally to increase the salability of certain of its assets through an act which we have power to control. For example: The Pennsylvania can now freely sell or pledge the Pan Handle stock which it holds, and expend the funds so obtained as it sees fit; but such a sale or pledge would be far more probable if this lease were executed without condition, for it would at once increase the marketability of the Pan Handle stock and make its retention in the

treasury of the Pennsylvania unnecessary for purposes of control.

These are some of the reasons, I believe, why the majority have attached the condition to their authorization of the lease that the Pan Handle stock which is directly or indirectly held by the Pennsylvania shall not hereafter be sold or pledged without our consent. With the intent of that condition I am in hearty accord. But the Pennsylvania has asked for approval or disapproval of the lease in the form in which it now stands. It has not indicated that conditional approval would be acceptable. On the contrary, the Pennsylvania has indicated that such a condition as the majority have attached to their authorization would be unacceptable, and that it is prepared to contest the lawfulness of such a condition in the courts. Under such circumstances, in my judgment, the Pennsylvania should be taken at its word, and authority to make the lease should be denied outright. No substantial public interest is at stake. Upon any theory, the eventual consolidation of the Pennsylvania with the Pan Handle, assuming that this will be in accord with the final consolidation plan under section 5 of the act, is far more to be desired than a 999-year lease.

In the above discussion, I have assumed that the lease as drawn virtually guarantees 4 per cent upon the Pan Handle stock until 1926, and 5 per cent thereafter. Apparently there is doubt as to this. Even if I were in other respects convinced that the lease is in the public interest, I should favor the withholding of approval until this doubt is removed. It is a simple matter to remove it, and no occasion exists for inviting possible future fraud upon minority stockholders. I am authorized to say that COMMISSIONER AITCHISON concurs in these views. . . .

CHAPTER XXII

RECEIVERSHIP AND REORGANIZATION[1]

1. Recent Railroad Failures and Reorganizations[2]

I

During the period from January, 1907, to December, 1917, some 59,846 lines of railroad in the United States were placed in receivers' hands. The capitalization of this mileage amounted to $3,735,499,496, or a sum equal to more than three times the national debt of the United States before the present war. Indeed, as late as December, 1916, between one-seventh and one-eighth of all the railroad mileage of the country was in charge of the courts.[3]

For convenient reference the mileage of railroads placed in receivers' hands during the last ten years may be tabulated as shown on page 541.

Geographically the bankruptcies were concentrated in the central portions of the country. No important railroad in Trunk Line territory went to the wall, none in the northwest, nor, with the exception of the Seaboard Air Line, was there any important failure in the old South. The accompanying map presents these facts in more detail.

Generally speaking, the failures were in the intensely competitive territory of the Central Freight Association, and in the less densely settled sections west and southwest of the Mississippi River. The south and east did not repeat their experience of the Nineties, while the transcontinental lines in the main this time managed to weather the storm.

During the whole period the number of great systems which

[1] See Jones, pp. 353–374.

[2] From Stuart Daggett, *Quarterly Journal of Economics*, vol. 32, pp. 446–486 (May, 1918). Reproduced by permission.

[3] On December 31, 1924, there were 10,487 miles of railroad in the hands of receivers. This was the lowest figure since 1912. It does not include the Chicago, Milwaukee and St. Paul, which failed in March, 1925. The St. Paul operates about 11,000 miles of railroad.—Ed.

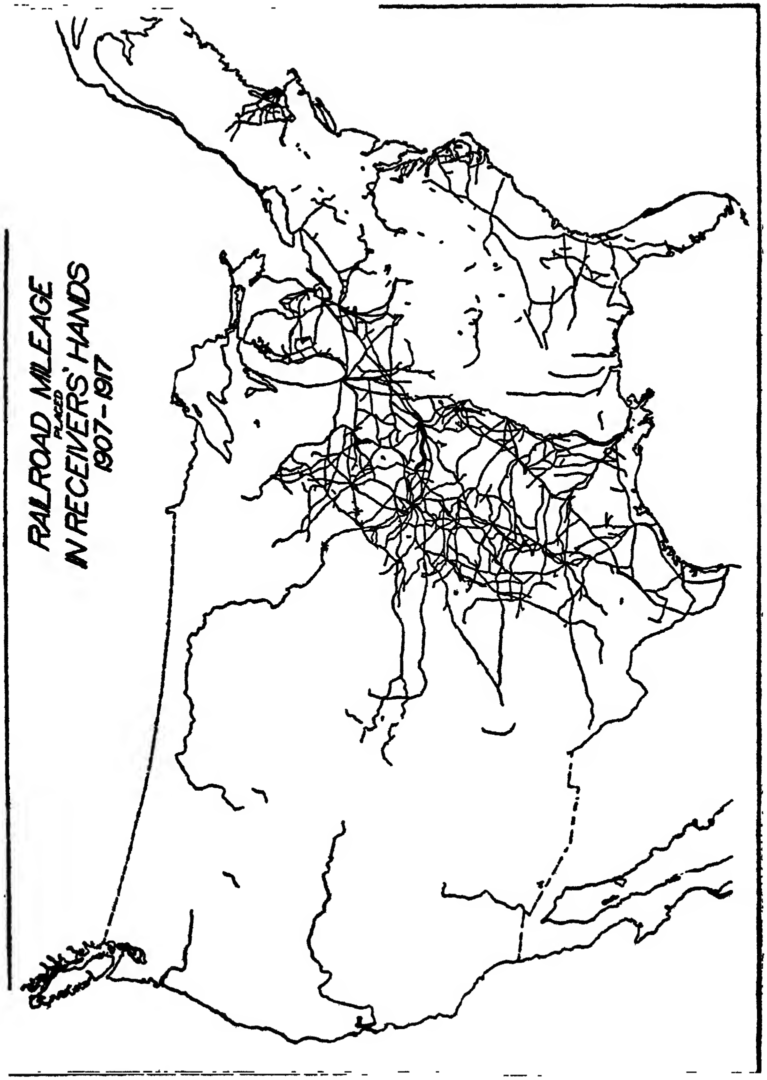


PLATE 22.

		Mileage		Number of operating companies
		Owned	*Operated*	
1907	Jan. to June	206.57	213.11	6
	July to Dec.	142.89	131.89	4
1908	Jan. to June	6,910.85	7,417.70	25
	July to Dec	907.36	1,009.43	8
1909	Jan. to June	742 21	723.27	7
	July to Dec	360.77	341.15	5
1910	Jan. to June	284.46	835.39	9
	July to Dec	298.27	52.95	5
1911	Jan. to June	176.10	163.95	8
	July to Dec	2,022.84	2,563.93	4
1912	Jan. to June	3,373 98	4,004.40	14
	July to Dec	606.81	689.27	4
1913	Jan. to June	5,026.63	6,344.78	12
	July to Dec	2,253.66	2,614.77	16
1914	Jan. to June	621.07	753.28	10
	July to Dec	3,269.86	3,404.00	15
1915	Jan. to June	9,065.35	10,281.93	4
	July to Dec	11,124.34	11,254.12	9
1916	Jan. to June	47.00	47.00	4
	July to Dec	2,603.45	4,304.39	5
1917	Jan. to June	2,046.88	2,056.46	12
	July to Dec	637.75	639.10	8
Total to Dec. 31, 1917		52,729.10	59,846.27	194

failed was comparatively small. Although one hundred and ninety-four companies in all entered receivership in eleven years, yet approximately 53 per cent of the total bankrupt mileage was embraced in three systems or groups of systems: first, the Chicago, Rock Island & Pacific; second, the St. Louis & San Francisco, including the Chicago & Eastern Illinois; third, the companies which at one time or another were combined under the leadership of Mr. Gould. The great outstanding facts of the period were, indeed, the inability of Mr. Gould to hold his transcontinental system together, and the separation and eventual collapse of the railroads at one time centralized under the financial management of the Moores and of Messrs. Reid and Yoakum, working through the Rock Island Company.

In order to get before us more fully the circumstances of the period so far as railroad failures are concerned, certain information will be given, relating not only to the three groups mentioned but to other important companies as well.

The following list of railroads includes all those failing between January, 1907, and December, 1917, which operated a mileage of over 500 miles. This list will form the basis of our detailed discussion:

Name of railroad	*Mileage operated*	*Receiver appointed*	
Seaboard Air Line	2,998	January	1908
Chicago Great Western	818	January	1908
International & Great Northern	1,160	February	1908
Western Maryland	543	March	1908
Wheeling & Lake Erie	504	June	1908
Norfolk & Southern	582	July	1908
Atlanta, Birmingham & Atlantic	641	January	1909
Wabash	2,515	December	1911
Kansas, Mexico & Orient	634	March	1912
Pere Marquette	2,330	April	1912
Chicago & Eastern Illinois	1,275	May	1913
St. Louis & San Francisco	6,042	May-July	1913
Cincinnati, Hamilton & Dayton	655	July	1914
International & Great Northern	1,160	August	1914
Western Pacific	946	March	1915
Chicago, Rock Island & Pacific	8,602	April	1915
Missouri Pacific	7,043	August	1915
Missouri, Kansas & Texas	3,621	September	1915
Boston & Maine	2,298	August	1916
Texas & Pacific	1,944	October	1916
Kansas City, Mexico & Orient	951	April	1917
Total	47,262		

Taken as a whole this is a distinctly weak group. Without going into details for each railroad included in it, the general statement may be made that the credit of no single system except that of the Boston & Maine was better than second class. In some cases, tho not in all, the capitalization per mile was high, and the fixed charges correspondingly great. In the majority of cases earnings per mile were below the average for the country or for the section in which the mileage lay, while expenses were not markedly inferior to this average. Two railroads, the Pere Marquette and the Seaboard Air Line, had recently been subject to receivership or reorganization. In the case of a number of others the management might properly be called speculative. This was particularly true in the case of the Rock Island and the St. Louis & San Francisco companies, but the whole Gould system was subject in a measure to the same reproach. Generally speaking, the percentage of fixed charges to net income was exceedingly high, especially in the later years of the period, and this was both a result and a cause of the low price obtained for new securities sold. Yet operating ratios were also high and increasing.

The first railroad of the group which failed was the Seaboard Air Line Railway, in January, 1908. The Seaboard Air Line was a company of some 2500 miles, connecting Richmond, Virginia, with Wilmington, Savannah, Atlanta, and Montgomery. It had been

organized in 1900 as a consolidation of a number of separate companies, but seems never to have been profitable. In part this was due to competition, and to the general low density of traffic in southern territory, but in part also to inadequate equipment, more or less demoralized organization, and consequent high operating expense. For a number of years before 1908 operating ratios ranged from 66 per cent to 79 per cent. The company's credit suffered also from a series of bitter disputes between Mr. John Skelton Williams, who had created the system, but who later was forced to retire, and a group of New York financiers who succeeded him. In 1904 backers of the company were compelled to organize a holding corporation in order to raise funds to pay Seaboard Air Line floating debts. In 1907 Seaboard Air Line earnings and income dropped below expenses, and in January, 1908, with declining revenue, and unable to market its securities, the company was obliged to suspend. Its total earnings for the year ending June 30, 1908, were \$16,810,514, and its expenses, including fixed charges, were \$18,100,703.

The second large failure was that of the International & Great Northern Railroad. This company had been skirting the edge of bankruptcy for years. In 1904, 1905, and 1906 it had earned less than enough to meet operating expenses and fixed charges, and in but one year between 1898 and 1907 had it secured a surplus of over \$100,000. The company's expenses were heavy, its business was light, and the condition of its roadbed and rolling stock poor. In the latter part of 1907 earnings began to decline, while about the same time the Texas Railroad Commission issued orders that certain improvements should be made, including the laying of ballast and the renewing of ties on portions of the line. There is every probability that the company would have been compelled to default without the Railroad Commission's order, but these new requirements placed the matter beyond question. Mr. T. J. Freeman was appointed Receiver on February 26, 1908.

Besides the Seaboard Air Line and the International & Great Northern no railroad failed in 1908 which operated as much as 1000 miles of line. Important among the smaller companies placed in receivers' hands were, however, the Chicago Great Western, the Western Maryland, the Wheeling & Lake Erie, the Wabash Pittsburg Terminal, and the Norfolk & Southern. The first three of these companies seem to have been caught with maturing indebtedness or outstanding short term notes which they found it impossible

to renew. The Wheeling & Lake Erie was also heavily overcapitalized, and suffered severely from a decline in earnings which took place in 1908. The Wabash Pittsburg Terminal had a debt of $50,236,000 on sixty-seven miles of line, and in 1908 failed to earn its fixed charges by over $900,000. The enterprise had been mistaken in its conception, and extravagant in its execution; its failure under any great pressure was to be expected. Under ordinary circumstances Mr. Gould might have been expected to assist these two essential links in his transcontinental line, but the fact that he had used the credit of his more prosperous companies in previous years to finance western extensions put it out of his power at this time to extend financial aid. The remaining company, the Norfolk & Southern, was a combined railroad and a lumber enterprise, organized in November, 1906, through the consolidation of five smaller companies. In the year ending June 30, 1908, it failed to earn its charges by $485,934 and found it necessary to charge to Profit & Loss some $726,102 more. Some readjustment of its financial obligations was a matter of evident necessity.

So far as the failures of 1908 are concerned, it is safe to say that they were the natural and normal result of crisis conditions acting on weak railroad systems. The general railroad situation was sound, but a few companies could not stand the strain. It is when we come to the latter part of the decade that conditions become more serious. . . .

The period 1907–1916 was one of rapidly increasing expenses of railroad operation. Prices of articles which the railroads had to buy grew higher all along the line, yet revenues did not grow to correspond. . . . Doubtless the better and stronger railroads of the country could resist pressure like this, for a time at least, but the weaknesses of other companies were pitilessly revealed. Generally speaking, the whole railroad net of the country was in a worse condition in 1911 than it had been in 1907 and was still worse in 1914 than in 1911. The renewal of panic conditions was certain to be more disastrous than it had been at the beginning of the decade, while even in times of relatively active business an increasing number of companies was likely to go to the wall.

The large railroad companies which failed between 1908 and 1914 were three in number: The Wabash in 1911, the Pere Marquetté in 1912, and the St. Louis & San Francisco, including the Chicago & Eastern Illinois, in 1913. One may speak of them as "ad interim" failures. The mileage of the Wabash lay in the

competitive territory between St. Louis and Toledo. It was an old road, heavily capitalized, which lacked money for necessary improvements, and even, according to its managers, for adequate maintenance. It had, moreover, become involved in heavy obligations in connection with its purchase of the Wheeling & Lake Erie Railroad and the Wabash Pittsburg Terminal, and had used for speculative extension credit which should have been employed to finance additions and betterments to its own lines. Even the exceptionally able management of Mr. F. A. Delano had failed to place the Wabash on a secure footing, while the refunding of its debenture bonds in 1906 had increased its fixed charges without substantially increasing its ability to raise funds. In the year ending June 30, 1911, the company failed to earn its interest charges by over $200,000. In the succeeding months earnings continued to decline. $7,500,000 were required immediately for new cars and equipment; yet the money could not be found. A committee to readjust the finances of the road was appointed in December, and a receiver was soon afterwards applied for.

The troubles of the Pere Marquette dated back many years. This company had failed in 1905 and had been reorganized two years later. In 1908 it fell short of earning its fixed charges by $393,667. In the two following years it managed to meet expenses, but in 1911 it fell behind nearly two million dollars and in 1912 its record was even worse. The fundamental difficulties of the company were due to the cutting over of the Michigan forests and to the consequent decline of its lumber traffic, to high capitalization, increasing expenses, and to legislative regulation of rates and fares. With fixed charges of $2473 per mile and net income of $1467 (in 1911) and with an operating ratio of 80 per cent it was not to be expected that it could remain solvent. The property was at one time controlled by the Cincinnati, Hamilton & Dayton.

The failure of the St. Louis & San Francisco Railroad is attributed by the Interstate Commerce Commission to the excessive prices paid for certain subsidiary properties, notably the Chicago & Eastern Illinois and lines in southern Texas; to the large profits made by insiders in connection with new construction in the Southwest; and to the sale of securities at such low prices as to indicate a deplorably weakened credit or extravagant arrangements with bankers. Many of these transactions resulted in substantial profits to Mr. Yoakum, the dominating influence in the St. Louis & San Francisco affairs, at the expense of the company itself.

Their result was a high and increasing funded debt, and interest charges which grew from $1741.91 per mile in 1897 to $2774.81 per mile in 1913. In 1902 interest charges absorbed 39.45 per cent of net earnings; in 1913 they absorbed 75.41 per cent. Failure occurred as the immediate consequence of the company's inability in 1913 to obtain the extension of $2,500,000 in short term notes which then fell due. The bankruptcy of the St. Louis & San Francisco carried with it the failure of its subsidiary, the Chicago & Eastern Illinois, a company which was also suffering in 1913 from high operating expenses and a substantial decline in earning.

Principal among the minor failures of the period were those of the Atlanta, Birmingham & Atlantic and of the Kansas City, Mexico & Orient. The former company was conceived and promoted in 1905 by Boston and Atlanta capitalists in order to develop the port of Brunswick, Georgia, in competition with Savannah. It was capitalized on the basis of an earning power which failed to develop and with the falling off in business in 1908, it passed into receivers' hands. The Kansas City, Mexico & Orient was an uncompleted project for a railroad from Kansas City, Missouri, through Kansas, Oklahoma, and Texas to the west coast of Mexico. The parties back of the scheme lacked adequate banking connections, and proved unable to sell sufficient securities after 1908 to enable them to continue with their plans.

This concludes the list of what have been called the "ad interim" failures. Each failure was that of a weak company suffering from mismanagement, excessive charges, or low earning capacity. Each took place, moreover, at a time when a rapid and general advance in railroad operating expenses bore heavily on railroad enterprises of every sort. We come now to the final group of railroad failures, those which occurred after the outbreak of the European war.

The immediate effect of the war was to give a severe shock to credit, which was followed by a sharp decline in railroad revenues. Somewhat later the increased prices due to war demands and to currency inflation intensified the strain to which railroads all over the country were subject. A considerable number of failures was normally to be expected.

The first considerable bankruptcy in 1914, however, occurred before the outbreak of the European war. This failure was that of the Cincinnati, Hamilton & Dayton Railroad. Fifteen years ago the Cincinnati, Hamilton & Dayton was a reasonably prosper-

ous undertaking, which operated 652 miles of line in the states of Ohio and Indiana, and reported a surplus of $558,000 for the year. According to the Interstate Commerce Commission, the company was forced by its owners after 1902 to finance a number of transactions which involved it in heavy loss. Reference is made particularly to the purchase of Pere Marquette stock for $125 a share, stock that was subsequently sold to J. P. Morgan & Co. for $23 a share at a loss aggregating over twelve million dollars, and to the retirement of the Dayton's own preferred stock by the sale of collateral trust interest-bearing notes. As a result of these and other operations, fixed charges grew from $1944 per mile to $3851, while the net income of the company declined from $2036 per mile in 1905 to $551 in 1914. There was not a year during the period when the company paid its way. In 1914 the operating ratio was 92 per cent, an increase from 74 per cent in 1912. The Cincinnati, Hamilton & Dayton had been placed in receivers' hands in 1905. It returned there in 1914 naturally and without power to resist.

In August, 1914, occurred the second failure of the International & Great Northern. This company underwent a sensational decline in earnings between 1913 and 1915, which cut its net income in half, and transformed a moderate surplus into a deficit of $1,121,397. The cause of its bankruptcy in 1914, however, was the maturity of eleven million three-year 5 per cent notes which had been issued under the reorganization plan of 1911, and which the company found it impossible to renew.

Five months later the Chicago, Rock Island & Pacific went to the wall. The net earnings of this corporation in 1914 were $2,454,106 less than they had been in the preceding year, while its fixed charges and taxes had increased by $342,883. The real reason for the failure, however, lay in the impaired credit of the company, which in turn had resulted from its reorganization in 1902, and from heavy losses incurred in connection with a series of financial transactions in which the Rock Island became involved under the direction of an unscrupulous and speculative management. These losses were estimated by the Interstate Commerce Commission to have amounted to more than twenty million dollars, spread over a period of about twelve years.

Following the failure of the Rock Island came in 1915 those of the Western Pacific, Missouri Pacific, St. Louis, Iron Mountain & Southern, and Missouri, Kansas & Texas. The Western Pacific was a railroad which was built by the Gould interests in order to

complete their transcontinental lines, and to free themselves from the domination of the Southern Pacific. It proved unable to earn as much as was expected, and cost between fifty-five and sixty million dollars instead of the thirty-five million dollars of the original estimate. The road was built entirely from the proceeds of bond issues, and failed for the very simple reason that it could not earn fixed charges of $2,500,000 per year.

The Missouri Pacific was likewise a Gould road, and one which suffered heavily from the inability of the Gould system generally to operate at a profit. The Wabash bankruptcy alone cost it several million dollars through the loss in value of the Wabash stock which it held. Like the Wabash the credit of the Missouri Pacific had been used to finance other Gould projects. Its capitalization was excessive, and for several years fixed charges had exceeded the net income. Notes to the amount of nearly twenty-five million dollars matured in 1914. The operating ratio of the company was high, but had not notably increased during the few years previous. The St. Louis, Iron Mountain & Southern was a part of the Missouri Pacific system and went down with it, suffering particularly from the inability of the Texas & Pacific to pay interest on Texas & Pacific income bonds.

Still another Gould property was the Missouri, Kansas & Texas, a system of 3865 miles reaching from St. Louis and Kansas City to San Antonio and Galveston. Representatives of bankers who examined the property in 1916 reported that this company would have to spend $64,764,750 in eight years to put it in first class condition and that the expenditure of $26,636,000 in two years was essential. Physically the railroad company was in poor condition. It also suffered from extremely heavy interest charges, and from a disproportionate amount of short time indebtedness. The system had expanded rapidly between 1910 and 1916 with inadequate capital and credit, under the control of parties who preferred dividends to the investment of surplus earnings in well conceived improvements. In 1914 the property had an operating ratio of 72 per cent, while fixed charges took up 93 per cent of its net income. This was not the kind of financial preparation calculated to meet successfully a decline of surplus revenue of $1,500,000 which took place the same year.

We have now to mention only two remaining bankruptcies, those of the Texas & Pacific, and of the Boston & Maine. Both occurred in 1916. The Texas & Pacific Railroad ran from New

Orleans to Sierra Blanca, Texas. It seems to have been in rather better financial condition at the time of its failure than most of the Gould lines, both in respect to capitalization and in respect to earnings. It was hampered in financing improvements, however, by an inelastic federal charter, and was forced into receivers' hands by the institution of suits demanding payment of certain overdue notes which the company was unable to meet, together with \$23,872,228 of interest alleged to be in default on second mortgage bonds. The Missouri Pacific owned practically all of the second mortgage bonds and a large block of Texas & Pacific stock.

The circumstances leading to the receivership of the Boston & Maine are fresh in the public mind. This failure did not take place in 1916 because of conditions peculiar to that year—on the contrary the earnings of the company in 1916 were unusually good. But the company was handicapped by its relations to a large number of subsidiary lines, the earnings of which no longer justified the rentals which were being paid them, by its connection with the New York, New Haven & Hartford, and by the unwillingness of its management to cease the payment of dividends long after the company's finances demanded such action. The decline in value of Boston & Maine stock from \$180.50 in April, 1906, to \$21 in January, 1918, was one of the severest blows which has been dealt the small investor in American railroad securities in recent years. The immediate cause of the failure was the maturing of a large quantity of short term notes, and the decision of the management to make no further effort to extend these notes in view of the pressing need for a general financial readjustment.

Summarizing the causes of the failures of the large railroad companies to which individual reference has been made, we may say in the first place that underlying conditions were largely responsible. The period 1908–1916 witnessed two severe shocks to railroad credit, one in 1907, and the other in 1914, each followed by a sharp decline in railroad earnings. Moreover, during all these years, a tendency of railroad operating expenses to rise more rapidly than railroad earnings is plainly discernible, due to causes over which the railroads had no control. Conditions like these imposed a strain upon all the railroads of the country, which the weaker companies proved unable to withstand. The reasons why certain railroads and not others, however, were the ones to succumb must be sought in the individual experience of the differ-

ent companies. Thus it appears that a number of railroads exposed themselves to disaster by undue reliance upon short time financing to meet their capital requirements. Such were the Chicago, Rock Island & Pacific, St. Louis & San Francisco, Chicago Great Western, Missouri Pacific, Wheeling & Lake Erie, and a number like them. Other companies, and this is true of most of those which failed, accumulated a load of fixed charges which only a continued period of prosperity could have enabled them to bear. Still others were guilty of unwise extensions, as in the case of the Western Pacific and the Wabash Pittsburg Terminal. Finally, there was the effect of legislation, competition, abuse of fiduciary position by parties in control, excessive dividends, and in some cases the long delayed result of policies adopted a generation before. The systems which failed were not as a rule financially sound—a fact which had to be taken into account in providing for their financial reorganization.

II

Out of twenty-one companies operating five hundred miles of line or more that failed between 1907 and 1917, five were set on their feet between 1909 and the end of 1911, ten were reorganized between November, 1915, and June, 1917, and six were still in receivers' hands at the time of writing (December, 1917). This last mentioned group includes the Chicago & Eastern Illinois, the International & Great Northern, Missouri, Kansas & Texas, Boston & Maine, Texas & Pacific, and the Kansas City, Mexico & Orient. With two exceptions, it consists of companies which have failed since August, 1914.

From the point of view of thoroness the completed reorganizations fall into two groups. In the first group, which includes the Chicago Great Western, Seaboard Air Line, Western Maryland, International & Great Northern (1911), and the Chicago, Rock Island & Pacific, the bankers in charge of proceedings contented themselves in the main with clearing away the existing floating debt, retiring one or more of the junior bond issues, usually small in amount, and in some cases, but not in all, making provision for the issue of bonds in the future to secure to the railroad system new capital as it was needed. In the second group may be placed those companies which, like the Norfolk & Southern, Atlanta, Birmingham & Atlantic, Cincinnati, Hamilton & Dayton, Western Pacific, Pere Marquette, Missouri Pacific, and St. Louis

& San Francisco, undertook a comprehensive readjustment of their capital obligations, with the intent not only to provide for pressing needs, but to reduce also fixed charges so drastically as to make future difficulties in the highest degree unlikely.

To some extent the difference between the two groups may be attributed to the dates at which the reorganizations took place. With one exception, the Norfolk & Southern, none of the large railroads which were reorganized between November, 1909, and September, 1911, accomplished any thorogoing readjustment. The later difficulties of the period were not then foreseen. On the other hand, eight out of the ten reorganizations which took place after the outbreak of the European war were marked by extensive reductions in fixed charges and by far reaching series of exchanges of old securities for new. Yet there were individual differences between the companies which also helped to account for the different policies pursued. The Chicago Great Western, which was the first of all the large corporations to emerge from bankruptcy, failed because of its inability to meet $3,342,545 in short term notes which had become due, and because of the threatening maturity of other similar issues. The problem of this company seemed therefore relatively simple. Its principal financial task was that of paying off its floating debt, and of providing certain necessary funds for future improvements. In the case of the Chicago, Rock Island & Pacific the reorganization was preceded by the foreclosure of the Chicago, Rock Island & Pacific Railroad collateral bonds secured by the stock of the operating company, which had the effect of sloughing off the top-heavy capitalization of the Rock Island Company, and left the railway company with relatively little to do in the way of readjustment of its own obligations. Doubtless also the prominence which inability to pay maturing obligations assumed in the weeks before failure had something to do with the nature of the reorganization of the Western Maryland. Yet here, as still more strikingly in the case of the International & Great Northern and the Seaboard Air Line, it proved unfortunate that the managers of the companies did not seize the opportunity to place their enterprises upon a permanently stable basis.

The first problem which the reorganizations from 1907 to 1917 had to meet was that of making provision for their cash requirements. The sums which the bankrupt companies had to raise during the period were large—in fact the cash requirements of the

fifteen companies under discussion amounted to more than $221,-000,000. This sum had accumulated in the usual way. It represented overdue interest, unpaid operating expense, and the ordinary run of floating debt which piles up before a railroad failure. In part also it was the result of the expenses of reorganization itself, for the cost of legal proceedings, counsel fees, syndicate commissions and the like often ran into large figures. Thus at the time its reorganization plan was published, the Western Pacific expected to pay nearly two million dollars for costs of reorganization. Nor was this unusually high. The Atlanta, Birmingham & Atlantic, a company operating only 641 miles of line, with net operating revenues in 1915 of less than $140,000, had to set aside $178,500 for counsel fees, $216,000 for commissions to syndicate managers and underwriting syndicates, and $269,771 for other reorganization expenses. The Pere Marquette paid $675,000 for the work of its reorganization committees alone, and estimated that the total expenses for readjustment of its finances would amount to $2,-679,000. The Wabash likewise estimated its expenses of reorganization at $3,449,500; and the Wheeling & Lake Erie proposed to raise for the same purpose $2,556, 249, a sum which included in this case a provision of working capital for the new company. These were very considerable sums for bankrupt companies to charge to their expense accounts.

On the other hand, a very considerable portion of the money raised represented new productive investment. In the case of the St. Louis & San Francisco this item of new investment amounted to nearly $11,000,000. In that of the Chicago Great Western, $9,892,274 was specifically set aside to cover the cost of rehabilitation, additional terminals, equipment, and shops. Likewise the Missouri Pacific provided $12,713,792 to cover the cost of additional working capital, new equipment and immediate improvements, as well as for readjustment expenses and the payment of loans. Other companies made varying but similar provisions. This was a very different matter from the cash requirements arising out of reorganization expense. The companies which raised money for physical rehabilitation possessed increased assets of considerable importance which might legitimately offset an increase in capitalization. Those which needed funds to pay counsel fees, on the contrary, had nothing but receipted bills for outlays which ought never to have occurred.

Cash requirements may be met by assessments upon security

holders, by the sale of stock or bonds, or by a combination of these two methods. Examination shows that only about one-half of the fifteen companies considered made any use of assessments as a means of raising cash. . . . The remaining companies relied on the sale of new securities to meet their cash requirements, protecting themselves against failure by contracts with underwriting syndicates. Examples of this procedure were the issue by the Seaboard Air Line and sale of $18,000,000 of adjustment bonds, the sale by the International & Great Northern of $11,000,000 three-year notes payable in 1914, and that by the Kansas City, Mexico & Orient of $5,640,200 six per cent notes payable two years after date. For the same purpose the Atlanta, Birmingham & Atlantic placed $30,000,000 of its common stock with a syndicate at the not unreasonable price of $12 per share, while the Western Maryland combined an assessment with an offer of stock to its former shareholders at $40. The best defense of this kind of financing is the fact that assessments are sometimes very difficult to collect, especially when the reorganization has been otherwise drastic. Yet in the case of the International & Great Northern and the Kansas City, Mexico & Orient the issue of short time notes was a direct cause of renewed bankruptcy, while the issue of large quantities of low grade securities by other companies was not calculated to improve their credit. When assessments were levied, preferred stock was usually given for the cash paid in, altho the St. Louis & San Francisco and Missouri Pacific offered new bonds in exchange.

With this brief outline of the provision which recent reorganization plans made for their cash requirements, we may pass to the question of fixed charges. The table on page 554 gives the fixed charges for interest and rentals before and after reorganization, for the principal railroads, the finances of which were overhauled during the period which we are considering.

FIXED CHARGES (INTEREST AND RENTALS)

Name of company	*Before reorganization*	*After reorganization*	*Percentage decrease*
Seaboard Air Line	$4,035,868	$3,681,091	8.79
Chicago Great Western	1,008,768	2,751,576	172.76[1]
International & Great Northern	1,918,008	1,379,137	28.09
Western Maryland	2,742,074	2,240,236	18.30
Wheeling & Lake Erie	1,849,516	875,713	52.65
Norfolk & Southern	1,101,468	509,049	53.79
Atlanta, Birmingham & Atlantic	1,279,122	204,500	84.01
Wabash	7,581,802	5,038,861	33.54
Kansas City, Mexico & Orient	1,033,758	338,412	67.26
Pere Marquette	4,492,256	2,352,476	47.63
St. Louis & San Francisco	12,160,995	9,158,190	24.69
Cincinnati, Hamilton & Dayton	2,417,803	1,251,553	48.23
Western Pacific	4,088,029	1,090,641	73.32
Chicago, Rock Island & Pacific	14,323,732	12,385,036	13.53
Missouri Pacific	13,354,005	9,773,233	26.81
Total	$73,387,204	$53,029,704	27.74

It is plain that a substantial reduction in fixed charges was the rule in these reorganizations. A single exception, the case of the Chicago Great Western, is accounted for by the unusual proportion of debenture bonds and stock in the capitalization of that corporation before reorganization took place. It must be remembered, moreover, that railroad property after reorganization is frequently able to bear heavier charges than before reorganization by reason of the considerable new cash investment in the road; and to the extent of this gain in strength a comparison of charges before and after reorganization gives a misleading result. Indeed, the fixed charges of $1,090,641, reported in 1917 by a company like the Western Pacific, represented almost entirely interest on new expenditure, which was confidently expected to earn its charges. Substantially the same can be said of the reorganization of the Atlanta, Birmingham & Atlantic, and to a greater or less extent it is true of all the companies for which figures are given.

The reader's attention is now directed to a comparison of the capitalization of fifteen bankrupt railroads after reorganization, with the capitalization of the same railroads before reorganization.

[1] Increase.

CAPITALIZATION BEFORE AND AFTER REORGANIZATION

Name of company	*Before re-organization*	*After re-organization*	*Per cent increase*	*Per cent decrease*
Seaboard Air Line...........	$139,108,500	$158,746,000	14.11	..
Chicago Great Western.......	125,223,351	122,999,013	..	1.79
International & Great Northern	38,765,350	35,457,000	..	8.53
Western Maryland...........	76,638,225	84,912,385	10.80	..
Wheeling & Lake Erie........	66,662,997	73,668,858	10.51	..
Norfolk & Southern..........	39,517,198	27,122,200	..	31.36
Atlanta, Birmingham & Atlantic	60,096,591	39,290,000	..	34.62
Wabash....................	200,685,377	205,118,000	2.21	..
Kansas City, Mexico & Orient .	50,582,751	25,640,200	..	49.31
Pere Marquette.............	108,325,129	105,000,000	..	3.07
St. Louis & San Francisco.....	284,508,618	319,221,998	12.20	.
Cincinnati, Hamilton & Dayton	62,732,775	33,746,650	..	46.21
Western Pacific.............	150,000,000	95,000,000	..	36.67
Chicago, Rock Island & Pacific..	331,197,105	360,940,994	8.98	..
Missouri Pacific.............	363,296,340	379,372,219	4.42	..
Total................	$2,097,340,307	$2,066,235,517		1 48

In five cases, those of the Western Pacific, the Cincinnati, Hamilton & Dayton, the Norfolk & Southern, the Atlanta, Birmingham & Atlantic, and the Kansas City, Mexico & Orient, the wiping out of junior securities or stock occasioned a considerable reduction in capitalization. The Norfolk & Southern sacrificed its preferred and common stock, and preserved only its prior liens and first refunding 5's, which together approximately represented the original cash investment in the property. The Cincinnati, Hamilton & Dayton reduced its general mortgage bonds and its outstanding obligations to the Baltimore & Ohio. The Kansas City, Mexico & Orient wiped out its preferred and common stock. The Atlanta, Birmingham & Atlantic eliminated its general mortgage bonds, while the Western Pacific repudiated its second mortgage bonds, altho these probably represented in large part actual investment. On the other hand, the Seaboard Air Line, the Western Maryland, the Wheeling & Lake Erie, the St. Louis & San Francisco and the Chicago, Rock Island & Pacific actually increased their capitalization as a result of reorganization; while other companies came out of receivers' hands with a capitalization not very different in respect to the total amount of securities outstanding from that with which they went in. Taken as a group no considerable attempt to reduce capitalization is apparent. It was not in this way that fixed charges were reduced.

Nor does it appear that the railroads which reorganized between 1907 and 1917 were able in any important degree to cut down the rates of interest which they were compelled to pay. In this respect the reorganizations of the period under review differed materially from those completed in the nineties, owing to the general rise in interest rates characteristic of the time. The following table illustrates this point by giving the aggregate bond issues at different rates for fifteen bankrupt companies both before and after reorganization.

RATES OF INTEREST BEFORE AND AFTER REORGANIZATION

(15 Roads)

Rate of interest	*Before reorganization*		*After reorganization*	
	Amount	*Per cent*	*Amount*	*Per cent*
3½	$5,569,950	.39	$5,569,950	.50
4	661,974,010	46.88	543,323,044	48.36
4½	57,098,140	4.04	51,043,140	4.54
5	550,366,090	38.98	390,402,573	34 74
6	132,201,319	9.36	131,035,318	11.66
7	348,000	.02	348,000	.03
8	1,211,250	.09	1,211,250	.11
Not specified	3,341,147	.24	683,770	.06
Total........	$1,412,190,906	100.00	$1,123,617,045	100.00

Among the large issues at low rates put out in the course of reorganization were the Missouri Pacific 4's maturing not later than 1975, and authorized up to one hundred million dollars; the St. Louis & San Francisco prior lien 4's, series A, maturing in 1950, and authorized up to two hundred and fifty million dollars; and the Seaboard Air Line's refunding 4's maturing in 1959 and authorized to a total of one hundred and twenty-five million dollars. Both the Missouri Pacific and the St. Louis & San Francisco put out new issues at 5 per cent, however, contemporaneously with those just mentioned, while it is to be noted that under the terms of their principal mortgages both companies reserved the right to place bonds at rates of interest not exceeding 6 per cent, if they should feel it necessary. There is apparent on the whole some decline in the percentage of bonds bearing interest rates of 5 per cent, but the change is very slight and the relief obtained from this cause inconsiderable. As compared with the reorganizations of the nineties a strikingly large proportion of the new securities put out during the last ten years bore interest at the rate of 5 per cent or higher.

The unsatisfactory condition of the money market is evidenced by the further fact that none of the large new issues of bonds under the various reorganization plans ran for more than fifty years.

The principal device by which reorganizing railroads reduced their interest charges between 1907 and 1917 was by the substitution of securities, the payment of the interest on which was optional, for securities which called for a fixed payment in good times or in bad. In other words, old mortgage bonds were called in and income bonds or stock issued in their stead. This was a practice already well known in the nineties. The following analysis of the total capitalization of fifteen bankrupt railroads before and after reorganization will make evident the sort of exchanges which took place.

Analysis of Capitalization Before and After Reorganization

Before Reorganization

Name of company	*Per cent mortgage bonds*	*Per cent income bonds*	*Per cent preferred stock*	*Per cent common stock*	*Total*
Seaboard Air Line	54.8	0.2	18.0	27.0	100
Chicago Great Western	14.6	22.4	27.5	35.5	100
International & Great Northern	74.8	..	..	25.2	100
Western Maryland	79.5	..	..	20.5	100
Wheeling & Lake Erie	44.5	..	25.5	30.0	100
Norfolk & Southern	50.1	..	12.1	37.8	100
Atlanta, Birmingham & Atlantic	41.8	..	16.6	41.6	100
Wabash	53.4	0.6	19.5	26.5	100
Kansas City, Mexico & Orient	46.0	..	27.0	27.0	100
Pere Marquette	71.1	4.6	11.0	13.3	100
St. Louis & San Francisco	83.0	2.1	7.4	7.5	100
Cincinnati, Hamilton & Dayton	86.8	..	0.4	12.8	100
Western Pacific	50.0	..	..	50.0	100
Chicago, Rock Island & Pacific	71.5	6.0	..	22.5	100
Missouri Pacific	77.2	..	..	22.8	100

Even a cursory glance at the table on page 558 will show that the following changes occurred.

After Reorganization

Name of company	*Per cent mortgage bonds*	*Per cent income bonds*	*Per cent preferred stock*	*Per cent common stock*	*Total*
Seaboard Air Line	44.7	15.9	15.7	23.7	100
Chicago Great Western	29.9	..	33.3	36.8	100
International & Great Northern	72.1	..	9 6	18.3	100
Western Maryland	60.0	..	11.8	28.2	100
Wheeling & Lake Erie	24.2	..	30.2	45.6	100
Norfolk & Southern	34.4	..	..	65.6	100
Atlanta, Birmingham & Atlantic	10.4	13.2	..	76.4	100
Wabash	32.3	0.2	46.3	21.2	100
Kansas City, Mexico & Orient	22 0	..	..	78 0	100
Pere Marquette	34.6	..	22.5	42.9	100
St. Louis & San Francisco	57.0	25.6	2.2	15.2	100
Cincinnati, Hamilton & Dayton	85 2	..	..	14.8	100
Western Pacific	21.1	..	28.9	50.0	100
Chicago, Rock Island & Pacific	65.6	..	13.8	20.6	100
Missouri Pacific	57.9	..	20.2	21.9	100

In the first place, the percentage of mortgage bonds to total capitalization was very much reduced. In the case of the St. Louis & San Francisco the reduction was from 83 per cent to 57 per cent; in that of the Western Pacific from 50 per cent to 21 per cent; in that of the Pere Marquette from 71 per cent to 34 per cent; in that of the Wheeling & Lake Erie from 44 per cent to 24 per cent; and in that of the Atlanta, Birmingham & Atlantic from 41 per cent to 10 per cent. These were the most striking instances of a reduction in the percentage of mortgage bonds to total capitalization, but some reduction occurred in every case save that of the Chicago Great Western, and here the elimination of the debenture 4 per cent stock was itself an achievement of some importance. It was by this cutting down of mortgage indebtedness that the reorganizations between 1907 and 1917 accomplished the saving in fixed charges which was their most important result.

In three important cases the reduction of mortgage indebtedness was accomplished by a material increase in income or debenture bonds. The largest use of such bonds was by the St. Louis & San Francisco railroad. This company put out two issues, one known as adjustment mortgage 6's, and the other as income mortgage 6's, to an aggregate of $75,739,818. Both were entitled to interest not to exceed 6 per cent, payable out of available net income. Interest on the adjustment mortgage was payable semiannually;

on the income mortgage annually; interest on the former was cumulative, on the latter noncumulative, and the lien of the income mortgage was inferior to that of the adjustment mortgage. Except for a slight difference in the dates of maturity the issues were otherwise similar. Both were offered in exchange for outstanding bonds, that is to say, holders of St. Louis & San Francisco Railroad Company 4's were offered 75 per cent in new prior lien mortgage 4's, plus 25 per cent in adjustment 6's for their holdings, and owners of general lien St. Louis & San Francisco 5's received 25 per cent in prior lien 4's, 25 per cent in adjustment 6's, and 50 per cent in income 6's. Preferred stock was used in connection with the retirement only of certain minor indebtedness. It is to be observed that the old prior lien and general lien bond holders thus received the right to a somewhat greater return than they had earned before, while surrendering the power to insist in any year upon the payment of any fixed amount whatever.

A second company which made use of income bonds was the Seaboard Air Line. Here there was but one issue of cumulative 5 per cent adjustment mortgage bonds, secured, as was also the case with the St. Louis & San Francisco securities, by a general lien upon all the property of the company, subject to prior mortgages. It was specifically provided that no interest upon any obligation secured by mortgage or lien junior to the lien of the adjustment mortgage, or upon any unsecured bond or debenture issued by the company subsequent to the date of the adjustment mortgage, nor any dividends upon any of the stock of the company could be deducted from net income for the purpose of determining the surplus net earnings applicable to interest on the adjustment bond. The Seaboard Air Line used its adjustment bonds in exchange for outstanding general mortgage 5 per cent bonds and over-due interest, dollar for dollar, to the sum of $6,979,500, and in addition offered $18,000,000 of them to stock holders at 70 in order to provide for cash requirements.

The third instance of the use of income bonds in recent reorganizations is afforded by the issue of $5,200,000 5 per cent income bonds by the Atlanta, Birmingham & Atlantic, for the most part in exchange for outstanding liens, certificates, and equipment trust bonds dollar for dollar, but also in part in order to raise cash. These bonds were noncumulative. The directors of the company were authorized, however, to reserve from net income in any fiscal year an amount not in excess of 20 per cent of the net income of

the Company, or in any event in excess of $100,000 in any single year, and to carry this to a so-called Income Bond Reserve Fund from which interest on income bonds might be paid in lean years in so far as the fund should be adequate.

In view of the assumption in current discussion that the day of income bonds has passed it is interesting to observe the very considerable reëmployment of this once popular form of obligation. It was evidently still thought possible by the companies which used income bonds to provide a security which by its lien, by its priority in the matter of dividends, and by its cumulative rights should enter the market on distinctly better terms than the most carefully guarded preferred stock.

On the whole, however, the retirement of outstanding bonds in recent reorganizations was effected more by the use of stock in exchange than by the offer of income bonds. This stock was endowed with the right to dividends at the rate sometimes of 4 per cent, but more generally at the rate of 5 or 6 per cent, when the earnings of the railroad might justify such a payment. In seven out of sixteen issues the dividends were cumulative. Holders of some preferred stock, such as that of the International & Great Northern and the so-called profit-sharing preferred stock of the Wabash, had, in addition to the right to receive dividends at the rate of 5 per cent, the privilege of demanding a pro-rata share in surplus earnings after the stock holders inferior to themselves had received 5 per cent.

Other provisions were as follows: without exception the preferred stock was given preference as to assets in case of liquidation, as well as to dividends in ordinary years, and in at least one case, that of the Wabash, this privilege extended to participation in surplus assets after other shareholders had received up to par of their securities. Preferred stock holders as a rule had equal voting rights with common stock holders. In the case of the Wheeling & Lake Erie prior lien stock holders were given the right to elect a majority of the directors under certain circumstances. Preferred stock was frequently convertible into common stock and was also redeemable at some stipulated price. Occasionally provisions appeared requiring the assent of the preferred stock before the directors might place additional mortgages on the company, or increase the amount of the preferred stock, or, as in the case of the St. Louis & San Francisco railroad, before they might lease additional property, guarantee interest or dividends on the securities

of other companies, or even acquire more than 25 per cent in amount of the stock of any other company.

In all this there is little not familiar to students of corporation finance, nor is the importance of attempts to protect preferred stock holders by elaborate provisions in their certificates probably very great. When a railroad is prosperous small differences in the privileges enjoyed by different classes of security holders may assume importance and be reflected in the price of stock. In times of stress, however, all stock holders are apt to fare very much alike. The following table shows the treatment accorded common and preferred shares of the companies which failed between 1907 and 1917 which had both common and preferred shares outstanding.

DISTRIBUTION OF NEW SECURITIES TO HOLDERS OF PREFERRED AND COMMON STOCK IN RECENT RAILROAD REORGANIZATIONS

Name of company	*Description of stock held*	*New securities given in exchange*		
		On payment of assessment	*New preferred stock*	*New common stock*
Chicago Great Western	Preferred A	..	..	120
	Preferred B	15	15	60
	Common	15	15	40
Wheeling & Lake Erie	First Preferred	27	27	100
	Second Preferred	27	27	90
	Common	27	27	87.50
Wabash	Preferred	30	50	50
	Common	30	50	45
Pere Marquette	First Preferred	9.75	10	20
	Second Preferred	9.75	10	20
	Common	9.75	10	20
St. Louis & San Francisco	First Preferred	50	50 [1]	100
	Second Preferred	50	50 [1]	90
	Common	50	50 [1]	82
Seaboard Air Line	No foreclosure	Old stock undisturbed		

In most instances referred to, common and preferred stock fared alike or so nearly alike that the differences were negligible. In the reorganization of the Wheeling & Lake Erie and St. Louis & San

[1] Prior Lien bonds.

Francisco some allowance was made for the superior position of preferred shares but none after all of any considerable importance. That the preferred A shares of the Chicago Great Western escaped assessment, and received double the amount of new common stock given to the holders of preferred B certificates, was doubtless due to the fact that the preferred B stock holders in this case enjoyed no preference over the common stock in respect to the assets of the railroad company, whereas the preferred A holders were entitled to such a preference and thus stood in a distinctly better position. On the whole, the experience of the group of railroads which we are considering is not satisfactory so far as preferred stock holders are concerned. The introduction of a cumulative feature in so many of the new preferred stock certificates may be taken as a recognition of this fact.

While preferred stock was issued in recent reorganizations in return for assessments, or in consideration for surrender of outstanding bonds, common stock was generally given to holders of common stock of the old company in recognition of their equity when that equity had value. It is interesting to observe, however, that more extended use was sometimes made of the common share certificate. In four cases companies retired outstanding bonds in whole or in part by exchange with common stock. The four were the International & Great Northern, which exchanged common stock for third mortgage bonds; the Western Pacific, which joined 75 per cent in common stock with 50 per cent in preferred stock in its offer to first mortgage bond holders; the Norfolk & Southern, which gave $1142.80 in new common stock for every one thousand dollars of its outstanding first and refunding bonds; and the Pere Marquette, which employed common stock as part consideration in the retirement of a large number of its mortgage securities. The intention in these cases was to be radical without cutting off old bond holders from every chance of financial recovery. More frequently common stock was exchanged for old stock outstanding before the reorganization took place, as has been said, or it was sold in an attempt to raise cash to meet pressing needs. . . .

Regarded as a whole, the result of recent reorganizations cannot be said to be encouraging to holders of railroad securities of the more speculative sort. A man who bought St. Louis & San Francisco general lien 5's in 1909 at 91 saw them decline to a low point of 27½ in 1914 and then rise to 82⅛ in November, 1916. By the

end of June, 1917, the aggregate market price of the securities offered in exchange for the bonds in question under the St. Louis & San Francisco reorganization plan would have been less than 57. The Pere Marquette refunding 4's of 1955 were quoted as high as 79 in 1910 and as low as 11½ in 1915. Under the reorganization plan of 1917, after payment of an assessment, they were exchangeable for common stock of the new company at the rate of $1104 in new stock for $1000 in old bonds. In June, 1917, this new stock was quoted about 53. Similar pyrotechnics characterized the record of the Wabash first refunding and extension 4's, and of the Missouri Pacific first and refunding 5's. Plainly such securities showed little of the stability commonly associated with the name of bond, while the general movement in all cases was downward. In most instances the reorganization plan provided for the retirement of large blanket issues of mortgage bonds by the issue of new stock, common or preferred, thus recognizing the uncertain nature of the security. Sometimes, as in the case of the St. Louis & San Francisco, income bonds were used. The following table shows the treatment accorded general mortgage bonds in the reorganization of the principal companies which had such issues outstanding.

TREATMENT OF GENERAL MORTGAGE BONDS

Name of company	*Name of security*	*Volume outstanding*	*New securities offered in exchange, per cent*			
			Mortgage bonds	*Income bonds*	*Preferred stock*	*Common stock*
Atlanta, Birmingham & Atlantic	First Mortgage 5's	$14,443,000 [1]	..	None	..	..
Cincinnati, Hamilton & Dayton	General Mort. 4's	17,529,000 [1]	70 [2]	..	..	..
Missouri Pacific	First Refunding 5's	29,806,000	..	..	100	..
Norfolk & Southern	First & Refund. 5's	14,000,000	..	..	..	114.28
Pere Marquette	Consol. Mort. 4's	8,382,000	..	..	110.40	..
Pere Marquette	Refunding Mort. 4's	14,789,000	..	..	..	110.40
Pere Marquette	Refunding Mort. 5's	17,157,942	..	..	..	50.00
St. Louis & San Francisco	Refunding Mort. 4's	68,562,000	75	25	..	..
St. Louis & San Francisco	General Lien 5's	69,384,216	25	75	..	..
Seaboard Air Line	General Mort. 5's	6,345,000	..	100	..	..
Wabash	First Refunding & Extension	40,600,240	..	..	120	..
Western Pacific	First Mortgage 5's	50,000,000	..	..	50	75

Mortgages junior to the general mortgage, when such there were, naturally fared no better than their superiors.

[1] Eliminated by foreclosure sale. [2] Cash.

As compared with the generally unfortunate record of the blanket bonds, the holders of equipment bonds and notes of the various companies had the pleasant experience in every case of being paid off in cash at par or of being left undisturbed. In between these two extremes came the various kinds of collateral bonds, which received much or little in reorganization, according to the nature of the security on which they were based. Thus the Norfolk & Southern collateral 6's, secured by pledge of equipment bonds, were paid in full in cash and the St. Louis & San Francisco trust mortgage 6's of 1880, secured by first mortgage bonds of the system, were given one hundred and twenty-five per cent in new mortgage securities. On the other hand holders of Missouri Pacific gold loan 4's, issued against the pledge of St. Louis, Iron Mountain & Southern stock, were allowed only new common stock for their certificates, and the owners of Pere Marquette collateral trust 6 per cent notes fared even worse.

From the point of view of reorganization technique two matters seem to deserve emphasis in this rapid survey of recent railroad experience in finance. The first is the increased use of preferred stock with right to cumulative dividend, and the considerable reliance upon the cumulative income bond. No less than nine examples of these two classes of securities are outstanding. Indeed, they account for a considerable part of the saving of fixed charges of which mention has previously been made. This practice, however, has little to commend it. Railroads are to some extent protected by it against formal bankruptcy, yet such formal bankruptcy is often better than the piling up of a huge load of unpaid dividends before a worthless and speculative common stock.

A second matter in which recent reorganizations have differed from those of a decade or so before has been in the very moderate increase in capitalization for which they are responsible. In most cases this increase has not much exceeded, if at all, the value of the improvements made during receivership, the increase in working capital, and the decrease in current debts. The reason has been the critical attitude of the public, acting in part through commissions such as those of California, Michigan, and Kansas, the difficulty in disposing of large amounts of new securities, and the fact that several of the current reorganizations, as those of the Chicago, Rock Island & Pacific, the Western Maryland and the Seaboard Air Lines, have been very partial affairs. Whatever the

cause, this change in policy has been an improvement. It has not only simplified the railroad balance sheet from the point of view of the government and the investor, but it has helped to discourage speculation by holding down the quantity of low priced stock desired only for control, or for the chance of a rise in market price which it affords.

The real test of a reorganization, however, is not to be found in the quantity of securities which are put out, but in the success of the measures taken in placing bankrupt companies on their feet. A reorganization is an expensive experience, to be justified only by genuine financial relief. In this respect recent reorganizations have been on the whole unsatisfactory. Two of them, indeed, are already known to have failed, and both for the same reason. The International & Great Northern in 1911 and the Kansas City, Mexico & Orient in 1914 both attempted to satisfy their creditors by the issue of short term notes. The International & Great Northern notes were put out in 1911 and matured in 1914; the Kansas City, Mexico & Orient notes were issued in 1914 and matured in 1916. Neither company was able to pay its notes at maturity, and renewed receivership in each case was the result; this in spite of a reduction of fixed charges by the reorganization plan of the Kansas City, Mexico & Orient of over 67 per cent. In addition to these instances the reduction in the fixed expenses of the Western Maryland by its reorganization was so slight that the company has been unable to meet its charges in three out of six years which have since elapsed.

The three other reorganizations among those discussed which were completed before 1915 have not as yet proved failures, but no one of them placed the company concerned in a very strong condition. The Chicago Great Western used 88 per cent of its gross income in 1916 to meet its operating expenses, fixed charges, taxes and rentals, and in that year for the first time earned as much as 4 per cent on its preferred stock. The position of the Seaboard Air Line was still worse. Neither company had cut its charges for interest and rentals at the time of reorganization in any important degree. The Norfolk & Southern, which had on the contrary materially reduced its fixed charges, nevertheless paid 92 per cent of its gross income in 1916 for various purposes before it could begin to provide for dividends or reserves. These statistics are to be compared with ratios of 67 per cent for the Great Northern & Union Pacific, 70 per cent for the Chicago,

Burlington & Quincy, and 80 per cent for the Pennsylvania. It is a pity that so many of the reorganizations of the group which we have discussed did not adequately meet the first requirement of any successful reorganization, that of reducing fixed charges to such a degree that solvency under any conditions reasonably to be expected should be assured.

For the most part the later reorganizations are too recent for confident judgment to be passed upon them. In general they were more thoro than their immediate predecessors, and better results may perhaps be expected from them. In two cases, those of the Western Pacific and of the Atlanta, Birmingham & Atlantic, all outstanding securities bearing obligatory interest were eliminated. In other instances the reorganizations were less radical—indeed, in the case of companies like the Missouri Pacific and Chicago, Rock Island & Pacific, they were not radical at all. It is highly doubtful whether the financial readjustments which have taken place would enable the majority of the reorganized companies to endure another period of pressure similar to that of the last decade. . . .

2. Approval by the Interstate Commerce Commission

a. Chicago and Eastern Illinois Case [1]

By Division 4:

The Chicago & Eastern Illinois Railway Company, a corporation organized for the purpose of engaging in transportation by railroad, subject to the interstate commerce act, seeks authority under section 20*a* of the interstate commerce act:

(*a*) To issue (1) $4,285,000 of prior-lien or first-mortgage bonds, $3,500,000 of these bonds to be pledged with the Director General of Railroads as security for a loan of the same amount which it is contemplated he will make to William J. Jackson, receiver of the Chicago & Eastern Illinois Railroad, and the remaining $785,000 to be pledged with the Secretary of the Treasury as security for a loan of like amount for which application has been made under section 210 of the transportation act, 1920 as amended: (2) $32,156,000 of general or second mortgage bonds: (3) $24,030,150 of preferred stock and (4) $25,500,000 of common stock;

(*b*) To assume an aggregate of $5,350,000 of underlying bonds and equipment obligations described as follows: (1) $91,000 of

[1] 67 I. C. C. 61 (February 3, 1921).

first-mortgage extension bonds of Chicago & Eastern Illinois Railroad Company, hereinafter called the railroad company; (2) $2,736,000 of the railroad company's first consolidated mortgage bonds; (3) $142,000 of the Evansville Belt Railway Company's first-mortgage bonds; (4) $1,640,000 of series-H equipment obligations issued by the railroad company; and (5) $741,000 of United States equipment notes issued by the railroad company's receiver to the Director-General of Railroads, United States Railroad Administration; and—

(*c*) In the event that the aforesaid loans of $3,500,000 and $785,000 shall be made, to issue and pledge with the Director General of Railroads and with the Secretary of the Treasury, respectively, as further security for said loans, additional prior-lien or first-mortgage bonds to such amounts as will furnish margin or additional security for each of said loans in the same ratio to the face amount of each such loan as the ratio of margin or additional security which we shall require to be pledged with the Secretary of the Treasury for said loan of $785,000.

On May 27, 1913, receivers were appointed for the properties of the railroad company, which receivership has continued since that time.

A decree was entered under date of May 22, 1917, by United States district judge George A. Carpenter in consolidated cause in equity No. 57, district court of the United States, northern district of Illinois, eastern division, ordering, adjudging, and decreeing the sale of said properties. A copy of the decree is filed in this proceeding.

Committees representing 90 per cent of the railroad company's general consolidated and first mortgage bonds, 80 per cent of its refunding and improvement mortgage bonds, 89 per cent of the Evansville & Terre Haute Railroad Company's first general mortgage bonds, 62 per cent of the latter company's refunding-mortgage bonds and substantially all of the railroad company's stock, which securities have been deposited with said committees under various agreements as shown by the application, have determined upon a reorganization program, more fully described in schedule I accompanying the application, and have agreed with substantially all of the creditors as to the proposed plan.

Applicant has been recently organized to purchase certain of said properties which are to be sold under the decree of foreclosure, and applicant desires authority to issue its securities and assume

underlying bonds and equipment obligations, as aforesaid, pursuant to, and in accordance with, the reorganization program, such issue and assumption being necessary to enable applicant to acquire those properties.

The following statement of the railroad company's outstanding stock and indebtedness, and that proposed by applicant, shows a reduction in liabilities under the reorganization program, as follows:

	Railroad company	*Applicant*
Capital stock	$19,377,268.88	$49,530,150.00
Bonds	60,408,000.00	39,410,000.00
Interest on bonds accrued and unpaid	18,550,681.03	....
Receiver's certificates	6,000,000.00	....
Equipment obligations	2,381,000.00	2,381,000.00
Guaranty of bonds, Evansville & Indianapolis Railroad	3,550,000.00	....
Loans and bills payable, and interest thereon	5,338,093.68	....
Net reduction	....	24,283,893.59
Total	115,605,043.59	115,605,043.59

Under the reorganization plan, $6,000,000 of receiver's certificates and $3,000,000 of Evansville & Terre Haute Railroad Company's first consolidated mortgage bonds maturing July 1, 1921, are to be paid and satisfied and, therefore, together with $12,293,000 of mortgaged indebtedness on certain properties not to be taken over by applicant, and interest thereon accrued and unpaid, will not appear in applicant's liabilities at completion of reorganization. Applicant's interest charges will be:

Underlying bonds and equipment obligations	$304,728
Prior-lien or first-mortgage bonds	257,100
General-mortgage bonds	1,607,800
Total	2,169,628

compared with corresponding charges as of December 31, 1920, of $4,288,581. Comparison between these amounts is subject to the qualification that applicant will not acquire all the properties formerly held by the railroad company, and certain obligations are to be eliminated from its liabilities by payment and cancellation thereof.

Under the plan of reorganization, the total capitalization will be $91,321,150. The valuation of the property which will be taken over by applicant has not yet been completed, so that it is not practicable to compare this capitalization with underlying value. It is clear, however, that the proposed new capitalization

will be relatively lower, even when allowance is made for the properties which are not to be taken over, than the outstanding capitalization of the old company, and that the fixed charges will very materially be reduced, with a consequent improvement in credit. The evidence also indicates that the new capitalization will not be disproportionate to the earning power of applicant. Under these circumstances, in view of the manifest desirability of ending the long period of receivership we think that approval ought not to be withheld because of lack of complete information as to the value of the property to be taken over by applicant.

Holders of small blocks of bonds have protested against the plan of exchanging bonds for stock. This is a matter properly to be brought before the court having jurisdiction in the premises, which has expressly reserved the determination of the equities in the receivership proceeding.

It is represented to us by the applicant, that with the issuance of the securities contemplated, the applicant will be amply financed, and thus will be in position fully and efficiently to perform its duties as a common carrier.

The application was made under oath and signed and filed on behalf of the applicant by one of its executive officers. As required by section 20a of the interstate commerce act, notice of the filing of the application has been given to, and a copy thereof filed with, the governor of each of the states in which the applicant proposes to operate. No objection to the granting of the application has been offered by any state authority.

We find that the proposed issue of prior-lien or first-mortgage bonds, general or second mortgage bonds, preferred stock, and common stock; the proposed assumption of obligation or liability in respect to said underlying bonds and equipment obligations; and, if said loans shall be authorized, the proposed issue and pledge of not more than $1,071,000 of additional prior-lien or first-mortgage bonds by the applicant (*a*) are for lawful objects within its corporate purposes and compatible with the public interest, which are necessary and appropriate for, and consistent with the proper performance by it of service to the public as a common carrier, and which will not impair its ability to perform that service; and (*b*) are reasonably necessary and appropriate for such purpose.

An appropriate order will be entered.

B. DENVER AND RIO GRANDE WESTERN CASE: DISSENTING OPINION [1]

EASTMAN, *Commissioner*, dissenting:

This is the third reorganization plan for the Denver & Rio Grande which the commission has approved. The first plan, approved in *Stock of Denver & Rio Grande Western R. R.*, 70 I. C. C., 102, was quite obviously unsound and broke down in short order. The second, approved in *Denver & Rio Grande Western Reorganization*, 82 I. C. C., 745, was modified to meet in part the objections of the State of Colorado when the case was reopened for rehearing and as so modified constitutes the third plan, which the majority now approve. I believed that neither the first nor the second plan was consistent with the public interest, and I am of the same opinion with reference to the third plan.

The new company will start business with the following capitalization:

Underlying mortgage bonds	$81,112,000
Equipment-trust certificates	4,500,000
General-mortgage bonds	29,808,000
Total funded debt	115,420,000
Preferred stock	16,445,600
Total par value	131,865,600
300,000 shares common stock without par value.	

Omitting the shares without par value, the funded debt will be 87.5 per cent of the total capitalization and the ratio of funded debt to stock will be 7 to 1. Figuring in the common stock at $100 per share, a far higher figure than any one would claim, the funded debt will be 71.3 per cent of the total and the ratio of funded debt to stock will be 2.5 to 1. I realize that the general-mortgage bonds are, in effect, to be income bonds for a period of five years, but in 1929 the interest upon these bonds will become a fixed charge, and by that time the underlying debt will have grown much larger.

For the past 10 years and more two things have been impressed upon us by the carriers and their financiers over and over again. One is the danger of a disproportionately large debt. The other is the desirability of financing the needs of the carriers in part by the issue of stock. I have no quarrel with either one of these propositions. Indeed I believe that ability to finance by issues of stock will ultimately prove essential if the railroads are to continue in

[1] *Denver and Rio Grande Western Reorganization*, 90 I. C. C. 141 (June 9, 1924).

private ownership. Nevertheless the railroad debt has increased by more than one billion of dollars since the termination of Federal control, while little new money has been procured through sale of stock. Nor does it appear that the financial advisers of the carriers have themselves kept in mind the precepts which they have urged upon us. Railroads with financial structures particularly well adapted to future financing through stock issues have impaired these structures from this point of view by the declaration of huge stock dividends. Moreover the opportunities for improving the situation in this respect which have been presented by receiverships and reorganizations have for the most part been neglected.

This Denver & Rio Grande reorganization is an excellent illustration. The new company begins business with a ratio of funded debt to stock far beyond the limit which we have repeatedly been told is safe and sound. That it is not anticipated that stock will ever be used as a means of financing is shown by the fact that no additional preferred or common stock can be issued without an amendment of the charter. Even if the charter were amended, no additional preferred stock of equal standing could be issued without the consent of the holders of two-thirds of the initial issue, so that, as a practical matter, the only recourse would be to an issue of second preferred stock or to an issue of the nondescript common shares without par value, which certainly offer no appeal to conservative investors. It is plain that the expectation is that the sole means of financing, apart from earnings and equipment trusts, will be the refunding and improvement bonds, and it is equally plain that as more and more of these are issued the already disproportionate debt will become still more disproportionate.

I realize the difficulty that reorganization managers have in dealing with the holders of the various classes of securities of an insolvent company. But here is where the commission should bring its influence to bear. The only policy which it has adopted with respect to reorganizations is that a proposed new financial structure will be approved if it seems better than the old structure and if there is reason to believe that earnings will be sufficient to cover the new fixed charges. Such a policy seems to me negative and inadequate. The least that can be expected of reorganization managers is that the new financial structure will in some measure be an improvement upon the old and that a plausible showing of earnings can be made for the future. But the transportation act, 1920, in-

troduced a new factor into the situation which should be made to count. That act recognized that the issue of securities is affected with a public interest and imposed upon us the duty of protecting that public interest. It can only be protected, in my judgment, by a positive and constructive policy on our part.

The capitalization of a carrier does not determine or limit its earnings, but may have a great deal to do with its ability to finance its needs and serve the public properly. Net earnings, whatever they may be, can be converted into interest or dividends regardless of the volume of the capitalization, but that volume and the ratio between stock and funded debt may determine whether the carrier is financially strong or financially weak. If a railroad becomes insolvent and its property is sold to satisfy its debts, we are subject to no other basic limitation than the public interest in determining the amount and character of the securities which the purchasing company may issue or assume for this purpose. It seems to me that we should at least insist, in the case of any such reorganization, that the new company shall start life with a reasonably sound financial structure. If this were our policy, reorganization managers would stand on firmer ground in dealing with the holders of the securities of insolvent companies than they now find under their feet.

For the reasons already indicated I am persuaded that the new company in this proceeding is not starting life with a reasonably sound financial structure and that we ought to withhold approval of the reorganization. And there are other reasons for this conclusion. To list three which come to mind:

1. Not only is the funded debt disproportionate to the stock, but of the very small amount of stock which it is proposed to issue the $16,445,600 of preferred stock is to have no voting power. The control of this great property, representing an investment of over $100,000,000, is to be concentrated in the shares without par value, which represent at best only an insignificant equity. In my judgment such concentrated control is contrary to sound public policy.

2. Such evidence as the record affords indicates that the new capitalization may be substantially in excess of the value of the property for rate-making purposes. Inasmuch as the right of the carrier to earnings is not determined or limited by capitalization, no sound reason can be offered for running any risk in this respect. A capitalization in excess of rate-making value is clearly contrary

to the public interest, since it endangers the financial stability of the company.

3. Great stress is laid by the promoters of the reorganization plan upon the fact that the new company is to enjoy the benefit, under certain conditions, of dividends from the Utah Fuel Company. It strikes me that it is dangerous to rely to any great degree upon this arrangement. It depends upon the transfer of the stock of the Utah Fuel Company to trustees for the ultimate beneficial interest of the Missouri Pacific and the Western Pacific and for the immediate beneficial interest of the new company. Paragraph (8) of section 1 of the interstate commerce act, the so-called commodities clause, reads as follows:

> From and after May first, nineteen hundred and eight, it shall be unlawful for any railroad company to transport from any State, Territory, or the District of Columbia, to any other State, Territory, or the District of Columbia, or to any foreign country, any article or commodity, other than timber and the manufactured products thereof, manufactured, mined or produced by it, or under its authority, or which it may own in whole or in part, or in which it may have an interest, direct or indirect, except such articles or commodities as may be necessary and intended for its use in the conduct of its business as a common carrier.

This language is broad and it has been broadly interpreted by the Supreme Court. Possibly the trust which has been created avoids its application, but in the event of any vigorous administration of the "commodities clause" it would not be well to bank too heavily upon that fact.

Summing up the matter, it seems to me that this reorganization plan has not been worked out with any intent to give the Denver & Rio Grande Western a financial structure under which it can, as an independent carrier, face the future with equanimity, but that it has been designed with the expectation that this carrier would be controlled by some other carrier or carriers and with a view to accommodating and facilitating such control. In a separate expression of opinion in *Denver & Rio Grande Western Reorganization, supra,* I said at page 766:

> I can not escape the conclusion that the arrangement is unsound and that the public interest would be better served if the reorganization of the Denver & Rio Grande property were postponed until such time as it can be reorganized in the interests of its security holders and the population which it serves, rather than

in the interests of connecting lines, and upon a financial plan which will enable it to face the future with a greater degree of confidence.

I adhere to this opinion.

I am authorized to say that COMMISSIONERS AITCHISON and MCMANAMY concur in this expression of dissent.

PART V

RAILROAD COMBINATION

CHAPTER XXIII

COMBINATION[1]

1. The Union Pacific Combination [2]

Lane, *Commissioner:*

On the 15th of November, 1906, the Commission on its own motion instituted the above-entitled proceeding by making the following order:

Whereas the act to regulate commerce provides that the Commission "shall have authority to inquire into the management of the business of all common carriers subject to the provisions of this act, and shall keep itself informed as to the manner and method in which the same is conducted," and also requires the Commission "to execute and enforce the provisions" of said act;

And whereas it appears to the Commission that consolidations and combinations of carriers subject to the act and the relations now and heretofore existing between such carriers, including community of interests therein, and the practices and methods of such carriers affecting the movement of interstate commerce, the rates received and facilities furnished therefor should be made the subject of investigation by the Commission, to the end that it may be fully informed in respect thereof, and to the further end that it may be ascertained whether such consolidations, combinations, relations, community of interests, practices, or methods result in violations of said act or tend to defeat its purposes:

It is ordered that a proceeding of investigation and inquiry into and concerning the matters above stated be, and the same is hereby, instituted. . . .

The investigation so far conducted under this order has related mainly to certain transactions of the Union Pacific Railroad Company, including the acquisition of control of the Southern Pacific Company, the purchase of large amounts of stock of various railroad companies, and other matters of kindred import. . . . The facts disclosed by the inquiry have been carefully considered and are made the subject of this report.

[1] See Jones, pp. 91–104, 325–351, and Vanderblue and Burgess, pp. 411–413.
[2] 12 I. C. C. 277 (1907). See Jones, pp. 341–345, 348–350.

THE HARRIMAN POLICY

Within three years after the reorganization of the Union Pacific Railroad Company in 1897 Mr. Edward H. Harriman became the dominating spirit in that corporation. As chairman of the executive committee he exercises powers that are well-nigh absolute. The directors have delegated their power "to manage and direct all the business and affairs of the company" to an executive committee of five members, who shall act "in such manner as such committee shall deem best for the company's interest in all cases in which specific directions shall not have been given by the board," and in turn the chairman of the executive committee is authorized to represent that body when it is not in session. Accordingly we find that in 1902 Mr. Harriman was "authorized to borrow such sums of money as may be required for the uses of this company, and to execute in the name and on behalf of this company a note or notes for the amounts so borrowed." The investigation showed that in practically all the great transactions of this company Mr. Harriman, as chairman of the executive committee, acted upon his own initiative, and his acts were subsequently ratified and approved by the executive ocmmittee. It may fairly be said, therefore, that the policies and purposes of the Union Pacific have been those of Mr. Harriman.

When the Union Pacific was reorganized it owned 1,822.59 miles of railroad, extending from Council Bluffs, Iowa, to Ogden, Utah, from Julesburg to Denver, from Denver to Cheyenne, from Kansas City to Denver (formerly known as the Kansas Pacific), and various branches extending into the territory on each side of these main lines. Previous to the reorganization the old company had control, through stock ownership, of the Oregon Short Line and Utah Northern Railway and the Oregon Railroad & Navigation Company. These companies were also reorganized, and shortly after the foreclosure sale the Union Pacific Railroad Company acquired by stock ownership the control of these companies, and has since acquired substantially all their stock. The Oregon Short Line owns the lines of railway from Granger, Wyo., on the Union Pacific, to Huntington, Oreg., and from Salt Lake City to Butte, Mont. The Oregon Railroad & Navigation Company owns the lines from Huntington, Oreg., to Portland, Oreg., together with a number of important branch lines in the States

of Washington, Idaho, and Oregon. Prior to the acquisition of the control of the Southern Pacific by the Union Pacific, the Oregon Railroad & Navigation Company also owned and operated a line of steamers from Portland to San Francisco and a line of steamers from Portland to Japanese and Chinese ports. The Union Pacific also owned one-half the stock of the Occidental & Oriental Steamship Company, which owned and operated a line of steamers plying between San Francisco and oriental ports.

EXPANSION OF UNION PACIFIC CONTROL

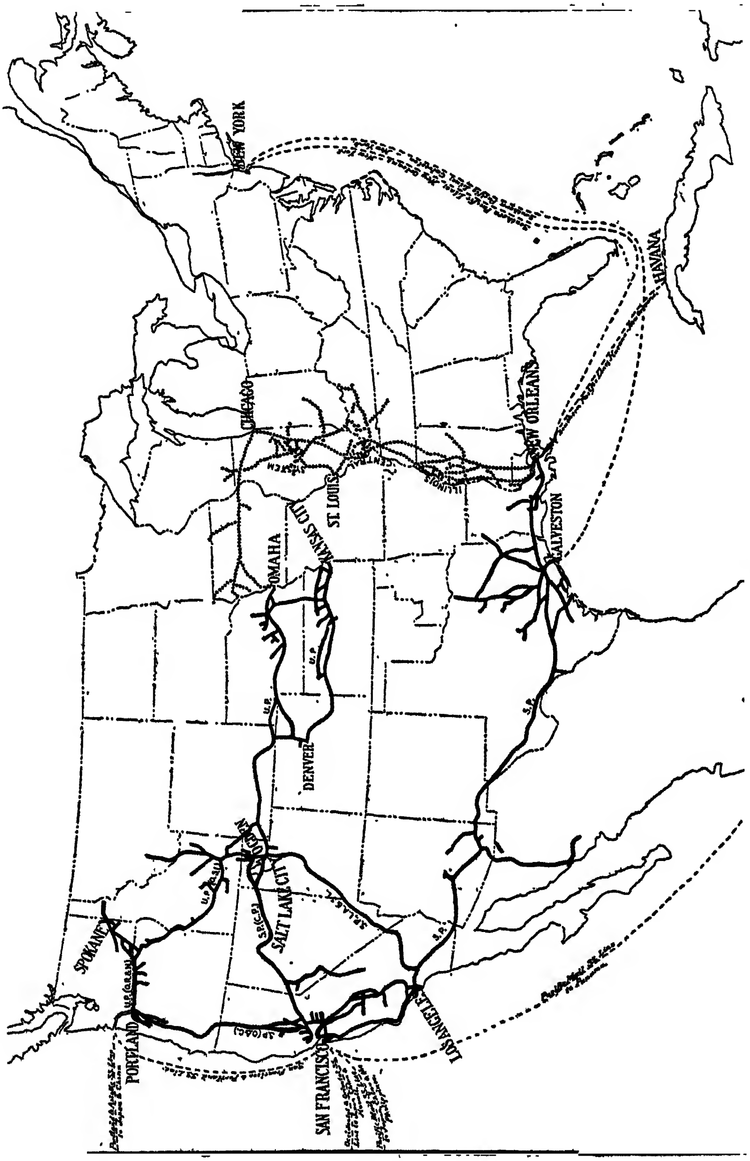
With these properties as a nucleus, and with the credit based on these assets, the Union Pacific has in the past six years so grown in power and influence that at this time [1907] it controls every line of railroad reaching the Pacific coast between Portland on the north and the Mexican border on the south—a distance as great as that from Maine to Florida—excepting alone the Santa Fe line, in which it has a large stock interest; and of his ability to "take" this road at any time the law will permit Mr. Harriman expresses no doubt. Among the lines thus brought under the same control, in addition to the Union Pacific, Oregon Railroad & Navigation Company, and Oregon Short Line, are these:

The San Pedro line, running from Salt Lake City, through Los Angeles, to San Pedro Harbor, on the Pacific coast, projected and begun by Senator Clark as an independent line, which Mr. Harriman stopped and absorbed.

All the lines of the Southern Pacific Company (a holding corporation), including—

> The Southern Pacific "Sunset Route," running by two routes from San Francisco to Los Angeles, and thence through Arizona, New Mexico, Texas, and Louisiana to New Orleans, with many extensive branches;
>
> The Central Pacific "Ogden Route," running from Ogden to San Francisco and from Roseville (near Sacramento) to the Oregon State line, with several branches;
>
> The Oregon & California Railroad, running from Portland to the California State line, which, with the Central Pacific's "Shasta Route," connects Portland with San Francisco.

In addition, the Union Pacific controls every regular line of trans-Pacific steamships operated out of the Pacific coast ports south of Puget Sound; also the Pacific Mail Line, plying between San Francisco and Panama; and the Morgan Line of freight and



MAP OF HARRIMAN LINES.

Solid lines.—Union Pacific, Southern Pacific Systems, and San Pedro Line. Dotted lines.—Illinois Central System. Dash lines.—Routes of water carriers operated in connection with Southern and Union Pacific.

PLATE 23.

passenger carriers, operated between New York City, Habana, New Orleans, and Galveston.

Mr. Harriman may journey by steamship from New York to New Orleans, thence by rail to San Francisco, across the Pacific Ocean to China, and, returning by another route to the United States, may go to Ogden by any one of three rail lines, and thence to Kansas City or Omaha, without leaving the deck or platform of a carrier which he controls, and without duplicating any part of his journey.

He has further what appears to be a dominating control in the Illinois Central Railroad, running directly north from the Gulf of Mexico to the Great Lakes, paralleling the Mississippi River; and 2,000 miles west of the Illinois Central he controls the only line of railroad paralleling the Pacific Coast and running from the Columbia River to the Mexican border.

Within a year his sphere of influence has extended eastward; the Union Pacific and Oregon Short Line have acquired 18.62 per cent of the stock of the Baltimore & Ohio, at a cost of $45,466,960, and have invested $19,634,324.93 in New York Central & Hudson River stock.

That it is only the law which prevents the concentration into Mr. Harriman's hands of every railroad line lying between Canada and Mexico is the frank admission of Mr. Harriman himself made at the hearing. Questioned by the Commission as to where his policy of acquisition was to stop, Mr. Harriman said:

A. I would go on with it. If I thought we could realize something more than we have got from these investments I would go on and buy some more things.

* * * * * * * * * *

Q. Supposing that you got the Santa Fe?
A. You would not let us get it.
Q. How could we help it?
A. How could you help it? I think you would bring out your power to enforce the conditions of the Sherman anti-trust act pretty quick. If you will let us, I will go and take the Santa Fe to-morrow.
Q. You would take it to-morrow?
A. Why, certainly I would; I would not have any hesitation; it is a pretty good property.
Q. Then it is only the restriction of the law that keeps you from taking it?
A. I would go on as long as I live.

Q. Then after you had gotten through with the Santa Fe and had taken it, you would also take the Northern Pacific and Great Northern, if you could get them?

A. If you would let me.

Q. And your power, which you have, would gradually increase as you took one road after another, so that you might spread not only over the Pacific coast, but spread out over the Atlantic coast?

A. Yes.

To gather under one head all existing transcontinental lines, or as many as possible, and to exclude the incoming of all competitors, became manifestly the Harriman policy, which was inaugurated in 1901 by the issuance of $100,000,000 of convertible bonds by the Union Pacific. With the proceeds of these bonds the Union Pacific purchased control of the Southern Pacific Company, and a majority of the outstanding stock of the Northern Pacific Railway Company, which latter incidentally carried with it control of one-half of the stock of the Chicago, Burlington & Quincy Railway Company, the stock of which had been purchased jointly by the Northern Pacific and Great Northern companies and their collateral trust bonds issued therefor. Possession of these lines would have given to the Union Pacific absolute mastery over every avenue leading to the Pacific coast within the United States save that afforded by the Great Northern railroad on the northern border of the country, and that offered by the Santa Fe upon the southern. This plan, if executed, would have subjected to a common will and policy nearly one-half of the territory of the United States—a comparatively undeveloped, rapidly growing, and extremely rich territory, into which must necessarily extend the population and business of the eastern States.

It has been, however, no part of the Harriman policy to permit the properties which were brought under the Union Pacific control to degenerate and decline; as railroads they are better properties to-day, with lower grades, straighter tracks, and more ample equipment than they were when they came under that control. Large sums have been generously expended in the carrying on of engineering works and betterments which make for the improvement of the service and the permanent value of the property.

The control of the Northern Pacific and the Burlington by the Union Pacific was prevented eventually by the decision of the Supreme Court of the United States in the case of *Harriman* v.

Northern Securities Company [1] in which that court held that it would be in violation of the Sherman Act for the Union Pacific to control these railways, as they were competing lines. The Southern Pacific remains within the control of the Union Pacific.[2]

CONTROL OF THE SOUTHERN PACIFIC

In all of its acquisition of stock control in other railroads the Union Pacific has either purchased the stocks directly itself or through the Oregon Short Line Railroad Company, which it owns and controls, and which for the purposes of this report will be considered as the Union Pacific. In the year 1901 the Union Pacific acquired 750,000 shares out of a total of 1,978,492 shares of Southern Pacific Company stock, and subsequently acquired 150,000 additional shares, making a total of 900,000 shares, or 45.49 per cent of the total stock issue of the Southern Pacific Company. Thereafter, when the preferred stock of the Southern Pacific Company was issued, the Union Pacific subscribed for its proportion, to wit, 180,000 shares, out of a total of 395,688 shares; so that at the present time the Union Pacific owns 1,080,000 shares out of a total of 2,374,180 shares.

The Southern Pacific Company is a holding corporation. It was organized under a special charter of the State of Kentucky in 1884, and was authorized to acquire by purchase or otherwise the stocks, bonds and securities of railway and steamship companies. Shortly after its organization it acquired the stocks of and controlled, and still does own the stocks of and control, a system of railroad extending from Ogden, Utah—where it connects with the Union Pacific—to San Francisco, Cal.; from San Francisco to Portland, Oreg.; and from San Francisco, through California, Arizona, New Mexico, Texas, and Louisiana, to New Orleans; and has since acquired a line of railroad into Mexico. It also owns and controls a line of steamships from Galveston, Tex., and from New Orleans, La., to New York and Habana. It is unnecessary to detail each separate railway corporation owning the sections of the various lines in these States; it is sufficient to say that through stock ownership it controls the entire Southern Pacific system, commonly known as

[1] 197 U. S. 244 (1905). See also Northern Securities Company *v.* U. S., 193 U. S. 197 (1904). On the Northern Securities Company, see Jones, pp. 339–341, 345–347.—Ed.

[2] Subsequent to the publication of the Commission's report the Supreme Court (in 1912) ordered the dissolution of the Union Pacific-Southern Pacific combination. See Jones, pp. 341–342, 348–350.—Ed.

the "Sunset Route." Of some of these lines the Southern Pacific Company has a lease and also owns the stock; of other lines, notably the Texas lines, it is simply a stockholding company, and controls them in that way.

Among the lines so owned and controlled is the Central Pacific Railroad Company, organized under the laws of Utah on July 29, 1899. This company was originally the Central Pacific Railway Company, organized under the laws of California, which, with the Western Pacific company (which was also organized under the laws of California and subsequently consolidated with it), constructed the line from San Francisco to Ogden, where it connected with the Union Pacific. This is the line originally known as the Central Pacific, which was to be operated with the Union Pacific as hereinafter stated. It subsequently acquired the line from Roseville (near Sacramento), Cal., to the Oregon State line, which was constructed by the California & Oregon Railroad Company, organized under the laws of California. The California & Oregon Railroad Company, of Oregon, constructed the line from Portland to the California State line, which company still owns that line. The Central Pacific company, therefore, owns the line extending from Ogden, Utah, to San Francisco, Cal., and the line from Roseville, Cal., to the Oregon State line. It has a capital stock of $67,275,500, par value, of common stock, and $12,800,000 of preferred stock, all of which is owned by the Southern Pacific Company; and the Southern Pacific Company also has a lease of its line. It was only the line from Ogden to San Francisco, however, which was required by the act of Congress, hereinafter referred to, to be operated in connection with the Union Pacific.

Immediately, however, upon the purchase of the Southern Pacific Company's stock the Union Pacific began the unification of the two organizations and the exercise of a control over the Southern Pacific which has effected a substantial elimination of competition between these two lines.

The Union Pacific and Oregon Short Line have at each annual meeting of the stockholders of the Southern Pacific Company since 1902 voted a majority of the stock represented at such meetings and have elected the directors and other officers. For several years last past the Union Pacific and Southern Pacific have had a majority of common directors, the same president, vice-president, director of traffic, director of maintenance and operation, secretary, treasurer, comptroller, auditor, legal department, and other chief

officials. Whereas formerly the two companies had separate commercial agents in the principal cities throughout the United States, soliciting traffic over their respective lines, they now have common agents and solicitors who represent the unified Union Pacific and Southern Pacific systems. While the Union Pacific, through the Oregon Short Line, does not own a majority of the stock of the Southern Pacific, yet it appears by the testimony that its control over it is, for all practical purposes, as absolute as though it owned every share; and it was admitted by Mr. Harriman that the Union Pacific controls the Southern Pacific.

ELIMINATION OF COMPETITION

Before the acquisition of its stock by the Union Pacific, the Southern Pacific Company, with its lines of rail and steamships, was engaged in competition with the Union Pacific for traffic moving between the Atlantic seaboard and the Pacific seaboard and between the Atlantic seaboard and oriental ports. Through their several connections by rail these lines were also engaged in competition for traffic from practically all points east of the Missouri River between the Great Lakes and the Gulf of Mexico. From Atlantic seaboard territory east of Buffalo and Pittsburg rates have generally been the same upon business destined to the Pacific coast, whether moving by the all-rail route, including the Union and Central Pacific, or moving by rail to an Atlantic port, thence by water to New Orleans and Galveston, and thence by Southern Pacific rails to Los Angeles, San Francisco, or Portland. Rates from this same Atlantic seaboard territory on traffic moving by the Southern Pacific steamships and its rail connections to Colorado common points have likewise been the same as on traffic carried by rail over the Union Pacific lines to such points, and of such traffic there is a great and increasing volume. It is doubtless true the competition which previously existed was not as complete as if the Union Pacific had a line of its own into San Francisco, instead of turning traffic over to the Central Pacific at Ogden. For all this traffic there exists at present no actual competition between the Union Pacific and the Southern Pacific lines.

Prior to the enactment of the interstate-commerce law the Union Pacific and Southern Pacific belonged to what was known as the Transcontinental Pool, in which each was regarded as a competitor of the other and was accordingly awarded an allotted percentage of transcontinental business; and there is on file with

this Commission a contract made in March, 1893, known as the Agreement of the Transcontinental Freight-Rate Committee, to which contract both the Union Pacific and the Southern Pacific were parties, and under which all of the traffic west of the Missouri River and passing through the gateways of St. Paul, Minneapolis, Sioux City, Omaha, Kansas City, and Sabine Pass, to and from California and Oregon, was treated as competitive transcontinental business.

The Union Pacific had access over the Oregon Short Line and Oregon Railroad & Navigation Company's line to Portland, and thence it could enter into competition with the Southern Pacific steamship lines for Alaskan, Oriental, and South Sea business. The Union Pacific also had an interest in the Occidental & Oriental steamship line operated out of San Francisco to Oriental ports. It also appears that the Oregon Railroad & Navigation Company has always had a line of steamships plying between Portland and San Francisco, which has at times done considerable business of certain classes, and has been and still could be made a factor in competition.

In 1900 the Southern Pacific Company purchased a majority of the stock of the Pacific Mail Steamship Company, which has for many years been the largest carrier of Oriental traffic to this country, and which has operated a line of steamships in connection with the Panama Railroad, by which Panama route traffic in large quantities has moved from Atlantic ports to Pacific coast points in competition with the all-rail carriers.

By virtue of the consolidation of the Union Pacific and Southern Pacific steamship companies all competition between these steamship lines has been destroyed; and there is some evidence on the record tending to show the impossibility of maintaining an independent steamship line running out of any of these ports without the consent of and arrangement with a connecting rail carrier.

The Santa Fe Company formerly had a line of steamships to the Orient connecting with its road at San Diego, Cal. Under an arrangement with the Pacific Mail Steamship Company for a division of the oriental business brought to this country by that company, and the other steamship lines for which the Pacific Mail acts as agent (including, singularly enough, a Japanese line known as the Nippon Yusen Kaisha), this independent Santa Fe line was abandoned in 1901. The percentage of this Oriental traffic allotted to the Santa Fe and the Southern Pacific, respectively, has varied

from time to time; but the understanding is that the amount to be delivered to the Santa Fe shall approximate 25 per cent of the total. This San Diego steamship line was not a financial success; and it is no doubt the truth that the Santa Fe officials were pleased to be relieved of the burden of its maintenance in return for a not inconsiderable proportion of the freight brought to San Francisco by the longer-established lines.

CONSIDERATIONS OF NATIONAL POLICY

It is a matter of large significance that our trade relations with the newly acquired territory of Hawaii and our Philippine dependencies, to say nothing whatever of the newly awakened lands on the other side of the Pacific Ocean, must depend to no slight degree upon the competitive relations between rail carriers reaching our Pacific coast ports.

There is a further consideration of national policy arising out of the history of the Union Pacific, the Central Pacific, and the Southern Pacific roads which distinguishes a combination of such roads. The Union Pacific and the Central Pacific were born out of national sentiment and need. The nation felt the necessity for rail connection to its isolated Pacific coast territory, and for this purpose, and to an unprecedented degree, pledged its own credit and donated its own lands to create a national highway between the Missouri River and the Bay of San Francisco. In every statute passed by Congress affecting these two roads there is to be found proof of the existence of such a policy. They were to be built toward each other—one from the east and the other from the west—and were to form one continuous line, which was to remain for all time available to the business and governmental necessities of our people. Under the act of June 20, 1874, "any officer or agent of the companies" (Central Pacific, Western Pacific, Union Pacific, Kansas City & Denver Pacific) "authorized to construct the aforesaid roads, or of any company.engaged in operating either of said roads, who shall refuse to operate and use the road or telegraph under his control, or which he is engaged in operating, for all purposes of communication, travel, and transportation, so far as the public and the Government are concerned, as one continuous line, or shall refuse in such operation and use to afford and secure to each of said roads equal advantages and facilities as to rates, time, and transportation, without any discrimination of any kind in favor of, or adverse to, the road or business of any or

either of said companies," is deemed guilty of a misdemeanor and punishable by fine not exceeding $1,000 and by imprisonment of not less than six months. The fact that the Union Pacific and Central Pacific companies were thereafter separately reorganized under the laws of Utah and acquired these lines does not relieve them from the public obligations imposed by the acts of Congress. . . . The Union Pacific was therefore forever guaranteed, without purchase, a connection with the Central Pacific upon terms as favorable as might be given to any other connection.

In the construction of these roads the people had in view the protection of the frontier in time of war, the settlement of a great wilderness west of the Missouri River, and the development of its resources; and to this end it was determined to procure the construction of a transcontinental line and to maintain it as a free, open, and continuous line of communication connecting with all railroads reaching Council Bluffs on the east, so that the public should have the benefit of a continuous line of transportation from the east to the Pacific coast unhampered by reason of the separate ownership and control of these lines of transportation. It is a fact that most of the lines of railway reaching Council Bluffs and Omaha were constructed with the view of connecting at these points with the Union Pacific railroad as the principal transcontinental line to and from the Pacific coast; and the Government has, perhaps, a peculiar obligation to maintain the freedom of this line.

In no other portion of the country is the Federal Government expending such large sums for purposes of development as in this great western region tributary to the Union Pacific and the Southern Pacific, and in no other part of the United States is the commerce of the country dependent upon so few railways covering so vast a territory and controlled by so few men; and in no part of the United States could such control have such far-reaching effect. The body of transcontinental and foreign commerce through Pacific ports has grown to enormous proportions, and its encouragement and development are of vital interest to the American people.

It is claimed by the Union Pacific that the principal reason for acquiring the Southern Pacific was to obtain the Central Pacific connection from Ogden to San Francisco. It is undoubtedly true that this is a desirable connection for that company; but, as we have seen, whether purchased or not, the Central Pacific is required

to form a through line of transportation with the Union Pacific and not to discriminate against it in the receipt and transportation of freight and through traffic. The public is entitled to all the advantages of this line as a competitive line of transportation with other transcontinental railways.

The various lines which now compose the Southern Pacific from New Orleans to California were also built under patronage of the Federal Government by the donation of many millions of acres of Government land, and formed an independent and separate route. While Congress did not prohibit in express terms the union of these great Federal railroad systems, it is hardly to be believed that such prohibition would not have been imposed had it been thought that in the course of time they would have been brought under a single control.

CONTROL OF SAN PEDRO, LOS ANGELES & SALT LAKE RAILROAD COMPANY

In or about the year 1902, William A. Clark and his associates commenced the construction of a line of railway from San Pedro and Los Angeles, Cal., to Salt Lake City, Utah. At that time the Oregon Short Line Railroad Company owned about 512 miles of railroad situated south and southwest of Salt Lake. About 324 miles of this was main line, running from Salt Lake to Caliente, Nev.; the rest was branches. Many years before, the predecessor of said Oregon Short Line, having in contemplation an extension of its line of road to the southwest, had acquired rights of way in the State of Nevada, upon which a small amount of grading had been done; but the construction of the line had been abandoned, the grading had gone to decay, and the right of way so obtained had been for years sold for taxes.

At the time Clark and his associates commenced the construction of their road there was no competition for traffic in and out of southern California as against the Southern Pacific, except such competition as was maintained by the Santa Fe. The San Pedro and Salt Lake road was projected as an independent competitive line with the expectation that it would exchange business at Salt Lake City with the Union Pacific system and with the Denver & Rio Grande-Missouri Pacific system, thus making in effect two new overland routes from the Mississippi River to Los Angeles.

Mr. Clark and his associates began by acquiring tax titles and

such other titles as could be obtained to the old grade of the Oregon Short Line and other abandoned rights of way and by relocating right of way for themselves. These abandoned rights of way were partly situated in a mountain canyon in the State of Nevada, known as the Meadow Valley Wash. This canyon is about 100 miles in length. Surveying parties were also put at work locating a line from Salt Lake toward the west; and other surveying parties were put at work locating a line through the Cajon Pass, in California, and thence to the northeast in the State of Nevada, and that portion of the line between Los Angeles, Cal., and Riverside, Cal., was constructed.

At this stage the Oregon Short Line, claiming to be the successor of the former owners of the right of way and grade through the Meadow Valley Wash, instituted legal proceedings to assert this ownership as against the Clark line. It is a fair inference that this was done for the purpose of preventing the construction by Clark and his associates of a line competitive with the Southern Pacific system. The Short Line also began the construction of a line leading toward the Meadow Valley Wash from its line in southern Utah, and threatened, in case Clark and his associates were successful in constructing a line of railway from Salt Lake to San Pedro, to parallel said road throughout.

In this contest between the Short Line and the Clark road the canyon known as the Meadow Valley Wash appears to have been a strategic point of vital importance. It was possible, but not practicable, to construct two lines of railway through this canyon. After some months of the above and additional litigation, Mr. Clark and his associates abandoned their purpose of constructing and maintaining an independent competitive line. A settlement and agreement was made between William A. Clark, representing the San Pedro Company, and Edward H. Harriman, representing the Oregon Short Line and Union Pacific. A preliminary contract was entered into July 9, 1902, which resulted in a permanent contract dated June 7, 1903. This final contract was between William A. Clark, Edward H. Harriman, and the Farmers' Loan & Trust Company. The trust company was to hold the stock of the San Pedro Company and act as trustee. The substance of this agreement was that the Oregon Short Line conveyed its 512 miles of railway south of Salt Lake to the San Pedro Company. The San Pedro Company was capitalized at $25,000,000, one half of the stock thereof belonging to the Oregon Short Line Company and

the other half to Clark and his associates. The stock was deposited with the Farmers' Loan & Trust Company as trustee. Shares were to be issued to proposed directors in order to qualify them, and trustees' certificates for the remaining shares were to be issued to William A. Clark, trustee, and Edward H. Harriman, trustee, by the trust company. In substance, the trust agreement provided that Mr. Harriman and Mr. Clark were to agree upon a board of directors. If they should fail to agree, each was to nominate one-half of the board and the trustee was to issue a proxy to some person or attorney to vote the shares for the persons so nominated. This made a joint control of the San Pedro Company.[1]

A further agreement was made between the Oregon Short Line, the Union Pacific, and the San Pedro companies, by which, among other things, it was agreed that the San Pedro and Short Line companies should not invade each other's territory northward and southward, respectively, from Salt Lake City, by building or aiding in the building of any main or branch lines of road other than those enumerated in the agreement. It was also provided that in the interchange of traffic as against competitors preference should be given each to the other by the contracting parties; business moving between points on the San Pedro line in Utah and points on the Short Line and Union Pacific and their connections was to be forwarded exclusively over the Short Line and Union Pacific. The San Pedro Company covenanted also to contract with the Southern Pacific Company to in the first instance adopt as its own rates all lawful rates used by the Southern Pacific for handling local traffic which was or might be subject to competition between the Southern Pacific and the San Pedro Company, and also to contract that thereafter neither party should change such rates without the consent of the other party, unless it was made necessary in order to meet the rates of another competing line of railroad.

To carry out this agreement a contract was made between the Southern Pacific Company and the San Pedro company, articles II and III of which read as follows:

ARTICLE II.

In partial consideration of the said covenants and agreements of the said Southern Company, contained in Article I hereof, said San Pedro Company hereby covenants and agrees with said

[1] In 1921 the Union Pacific acquired the remaining half of the stock of the San Pedro line, and thereby secured complete control.—Ed.

Southern Company that it will, upon the execution of this agreement, adopt, print, publish, and put in force at all points upon its leased, owned, or operated railroad, for the handling of local business thereon, the lawful rates, tariffs, classifications, and charges used by said Southern Company for the handling of any local business which may be the subject of competition between them.

ARTICLE III.

Each party hereto mutually covenants and agrees to and with the other that after the adoption and putting in force of rates as provided by Article II hereof, neither of them shall or will change any such rates without the consent of the other party hereto unless such change may be made necessary in order to meet the rates, charges, classifications, or tariffs of any other company or competing line of railroad or to conform to the final decree or judgment of some court of competent jurisdiction, or some lawful and valid requirement of State or national law.

It is claimed by the Southern Pacific Company that these articles relate only to traffic local to the State of California and the contract was not, therefore, in violation of the laws of the United States; but in our opinion this contract can not be so construed.

Since the hearing in this matter this traffic contract has been abrogated and canceled by the Southern Pacific Company and the San Pedro, Los Angeles & Salt Lake Railroad Company, and notice thereof given to the Commission. The ground of such cancellation, as stated by the counsel of the company, is that the legislature of California at its last session enacted a statute prohibiting contracts in restraint of competition, and that the validity of said contract would be open to question upon the taking effect of said act.

INTEREST OF THE UNION PACIFIC IN OTHER ROADS

The Union Pacific Railroad Company has not confined its corporate energies and powers to the acquisition and management of lines of transportation, but has issued a great volume of stock and securities with which it has purchased stocks of other railways. It has been known for a number of years that the Union Pacific, and under its direction the Oregon Short Line, had acquired stock in the Northern Pacific and in the Southern Pacific; but the amount of stocks purchased in other railways, and the extent to which the Union Pacific had become a great investment company, was first developed upon this hearing.

It appears by the plan of reorganization that the Union Pacific Railroad Company, prior to such reorganization, had outstanding a total funded debt of $140,425,862, and stock in the amount of $60,-868,500, making a total of $201,294,362. This did not include its collateral trust obligations on stocks and securities owned in other roads. These collateral trust obligations did not participate in the reorganization. The total mileage of the company was 1,822.59 miles. This road was reorganized; but by such reorganization the total of its securities was not reduced. It issued against these 1,800 miles of road the following bonds and stocks:

4 per cent first-mortgage bonds	$100,000,000
Preferred stock	75,000,000
Common stock	61,000,000
Total	236,000,000

It gave to the old first-mortgage bondholders new bonds to the par value of their old bonds and substantially 50 per cent in preferred stock. For an assessment on the common stock it gave preferred stock and for the common stock it gave share for share of the new common stock, thereby issuing $236,000,000 of securities in lieu of $201,294,362 of obligations outstanding at the time of the reorganization. It appears that some of the new securities were issued for equipment of the new company's lines. The exact amount is not revealed, but Mr. Kahn testified that he thought between $5,000,000 and $10,000,000.

On January 31, 1901, as has already been stated, the Union Pacific, in pursuance of its purpose to purchase the stock of the Southern Pacific Company and the Northern Pacific Railway Company, issued $100,000,000 of convertible bonds, which were sold, and from which and the profits resulting from the fortunate investment in Northern Pacific have flowed the great body of the purchases of stock in other railways made by the Union Pacific. These convertible bonds have all been converted into common stock, so that there is now outstanding $100,000,000 of common stock of the Union Pacific Railroad Company which has been issued and used exclusively for the purchase of stock in other railroads.

The Oregon Short Line Railroad Company also issued, and has now outstanding, $45,000,000 of bonds known as 4 per cent refunding bonds, secured by a mortgage on its lines of railway, the proceeds of which have been used exclusively for the purchase of stock in other lines, and this last-named company in September,

1906, gave its notes to Kuhn, Loeb & Co. for the purchase of Baltimore & Ohio stock amounting to $36,393,432.

Thus the Union Pacific and its connecting and subordinate line, the Oregon Short Line, have assumed obligations which are now outstanding amounting to approximately $181,000,000, all of which has been used in the purchase of stock in other railroads.

Southern Pacific.—With the affairs of this company we have already dealt. The original 750,000 shares of Southern Pacific stock were purchased with the proceeds of $40,000,000 of Union Pacific convertible bonds sold through Kuhn, Loeb & Co.

Northern Pacific.—The Union Pacific purchased in 1901, at a cost of $79,459,691.36, what it believed to be a control of the Northern Pacific, and through it of the Chicago, Burlington & Quincy Railway. The Union Pacific sought in the dissolution of the Northern Securities Company to obtain control of the Northern Pacific through stock ownership. The Supreme Court, as before stated, held such control to be in violation of the Sherman Act. Thereafter the Northern Securities Company was liquidated, and the Union Pacific received its pro rata share of stock in the Northern Pacific and Great Northern and Northern Securities stubs. Subsequently the Union Pacific acquired 37,444 additional shares of Great Northern stock, under rights, costing $3,744,400. Of these stocks the following sales were made:

Stocks	*Number of shares*	*Sold for—*
Northern Securities	100,000	$16,880,019.46
Northern Securities stubs	0.1871	56.13
Northern Pacific	240,300.8215	50,166,357.97
Great Northern	163,600.8949	49,801,576.47
Total	....	116,848,010.03

Leaving now in the hands of the Union Pacific and allied companies the following number of shares:

Northern Securities stubs	7,249
Northern Pacific	41,528
Great Northern	90,364
Great Northern ore certificates (received on account of Great Northern stock)	90,364

The Sante Fe.—Mr. Ripley, president of the Santa Fe Company, testified in substance that in the summer of 1904 Mr. Harriman, Mr. Schiff, and Mr. Frick had a conversation with him, in which

Mr. Harriman stated that he and some of his friends had been buying Santa Fe stock because they believed it was a good investment and asked for representation on the Santa Fe board of directors. Mr. Ripley stated that under the cumulative system of voting they could have elected two directors whether he liked it or not, and answered Mr. Harriman that if he and his associates would name two men who were not officials of competing lines he would have them elected to the Santa Fe board. He said that he had investigated the matter and had satisfied himself that these gentlemen owned about one-seventh of the total issue of stock in the Santa Fe, or about $30,000,000 worth. Mr. Henry C. Frick and Mr. Henry H. Rogers were named, and were elected directors of the Santa Fe. They were at that time, and ever since have been, directors of the Union Pacific also.

It appears, further, that the Oregon Short Line, on or about July 10, 1906, purchased $10,000,000 of the stock of the Santa Fe Company at a cost of $10,395,000. Whether this is a part of the stock previously owned by Mr. Harriman or the other directors of the Union Pacific he refused to state, so that we can not tell whether the amount of Santa Fe stock now controlled by the Union Pacific and its directors is $40,000,000 or $30,000,000.

The control of this stock by the Union Pacific, it is safe to assume, has not been without effect upon the relations of these two companies. We have already noted the abandonment in about 1901 of a competing trans-Pacific steamship line running from San Diego, in consideration of a division of traffic with the Santa Fe; and now although about 60 per cent of the packing houses shipping citrus fruits out of southern California are located upon the tracks of the Santa Fe, that traffic appears to be divided approximately upon the following basis: Forty-five per cent each to the Santa Fe and the Southern Pacific, and 10 per cent to the San Pedro, Los Angeles & Salt Lake line.

The close affiliation of the Southern Pacific and Santa Fe systems has been further shown by the recent incorporation of the Northwestern Pacific Railroad Company, in which each interest is the owner of one-half of the capital stock. Prior to the organization of this corporation the Santa Fe and the Southern Pacific companies owned certain distinct and separate lines of railroad north of San Francisco Bay, those owned by the Santa Fe running southerly from Humboldt Bay and those owned by the Southern Pacific running northerly from San Francisco Bay. Both lines were

actively engaged in construction work, each pushing into the territory of the other; the Southern Pacific lines reaching out for the great timber districts surrounding Humboldt Bay and the Santa Fe lines extending southerly so as to make connection with the main line upon the Bay of San Francisco. Upon the incorporation of the Northwestern Pacific Company all of the lines owned by the Santa Fe and Southern Pacific were transferred to this new corporation under a contract by which the lines now in existence and the connections between the same to be constructed by the Northwestern Pacific shall be owned by this new company, and the board of directors of the Northwestern Pacific is to be divided between the Southern Pacific and the Santa Fe. . . .

Illinois Central.—The Illinois Central can not be regarded as a competing line with the Union Pacific; but it is a competing line with the Chicago & Alton Railway, which is jointly controlled, through stock ownership, by the Union Pacific and the Rock Island, and is manifestly a competing line with the Rock Island. In connection with the Union Pacific the Illinois Central would be competitive with the Southern Pacific. It owns lines of railroad extending from Chicago to Omaha, St. Louis, and New Orleans. At Council Bluffs it connects with the Union Pacific, and at New Orleans with the Southern Pacific. A very considerable part of the business originating on the Illinois Central between Chicago and New Orleans destined for Pacific coast points may go by either route; that is, it may go south to New Orleans and thence via the Southern Pacific, or it may go to Omaha and thence via the Union Pacific. Before the control of the Southern Pacific by the Union Pacific, these two companies were in active competition with each other for business originating on the Illinois Central system.

The Illinois Central, as a glance at the map will show, is the eastern side of a railroad parallelogram, the other three sides of which are the Union Pacific and Short Line system to Portland on the north, the Southern Pacific system from Portland to Los Angeles on the west, and from Los Angeles to New Orleans on the south. Since June 30 of last year the Union Pacific has purchased 29.59 per cent of the capital stock of the Illinois Central, or 281,231 shares out of a total of 950,400 shares. Mr. Kahn, of Kuhn, Loeb & Co., testified that this was sufficient generally to secure a dominating interest in a railroad corporation. That Mr. Harriman was not indifferent to the strategic value of this road with relation to the

Southern Pacific and Union Pacific lines is manifest from the following statement made by him to the Union Pacific board of directors as recorded in the minutes of the meeting of July 19, 1906:

> That he believed it to be the interest of the Union Pacific Railroad Company to purchase stock of the Illinois Central Railroad Company; that, while the Union Pacific line served a large grain-producing territory, it had no line from that territory to the Gulf or to Chicago, and into the southeast; that the export of grain via the Gulf ports is likely to increase steadily; that the value and importance of a system of railroads extending from the Missouri River, at and above Omaha and as far north as Minnesota and Wisconsin, and from Chicago and St. Louis on a low grade to New Orleans, as does the Illinois Central, will be enhanced by the construction of the Panama Canal, and the importance and value of such connections to the Union Pacific will be very great; that, while the Illinois Central was generally recognized as an important and valuable system of railroads, yet he believed its strategic value and importance was but little understood and appreciated even by some of those most active in its management; and that while this stock appeared to be a good investment at prevailing prices, he believed it could be made and in time was bound to become very much more valuable.

Of the stock so purchased by the Union Pacific, E. H. Harriman owned 30,000 shares; H. H. Rogers, 30,000 shares; James Stillman, 30,000 shares; all of said parties being directors of the Union Pacific; and Kuhn, Loeb & Co., fiscal agents of the Union Pacific, 105,000 shares. Mr. Harriman declined to testify as to whether this stock was acquired by a syndicate or pool for the purpose of sale to the Union Pacific, or as to whether he was interested in the 105,000 shares which were bought from Kuhn, Loeb & Co. And Mr. Kahn, of that firm, declined to state whether any part of the 105,000 shares so sold was held by his firm for or on account of all or any of the directors of the Union Pacific. It is undoubtedly a fact that Mr. Harriman dominates the Illinois Central; and in view of the large block of stock owned by the Union Pacific it is quite likely this power can be continued. Ordinarily, where the stock of a railroad company is widely scattered, it is impossible to obtain a full vote at a stockholders' meeting; the management and control have possession of the stock books and the stock lists and can send out for proxies; and 30 per cent of the stock in a single ownership is frequently sufficient to control the management.

STOCKS PURCHASED SINCE JUNE 30, 1906

Without going further into details it is sufficient for the purpose of this report to say that the Union Pacific and the Oregon Short Line companies, from June 30, 1906, to February 28, 1907, purchased stocks, and paid on subscriptions to stocks, in railway and other transportation companies, as below shown:

Issuing company and stock.	*Par value of total outstanding.*	*Amount purchased since June 30, 1906.*			
		Par value.	*Fraction of total.*	*Cost.*	*Per-centum price, average.*
			Per cent		
Atchison, Topeka and Santa Fe: Preferred stock......	$131,486,000.00	$10,000,000.00	7.61	$10,395,000.00	103.95
Common stock......	102,000,000.00	None.	......	....	......
Baltimore and Ohio:					
Preferred stock......	60,000,000.00	7,206,400.00	12 01	6,665,920.00	92.50
Common stock.......	152,330,060.00	32,334,200.00	21.23	38.801,040.00	120.00
Chicago, Milwaukee and St. Paul: Preferred stock....	49,654,400.00	None.	......	....	......
Common stock.......	58,183,900.00	3,690,000.00	6.34	5,997,750.24	162.54
Subscription to stock 10 per cent paid—					
18,450 shares preferred	....	....	......	184,500.00	......
9,225 shares common	....	....	......	92,250.00	......
Chicago and Northwestern:					
Preferred stock.....	$22,398,954.56	None.	......	....	......
Common stock.....	77,516,745.97	$2,572,000.00	3.32	$5,303,673.94	206.21
Fresno City Railway stock..	....	495,650.00	......	106,410.98	21.47
Illinois Central, stock.......	95,040,000.00	*28,123,100.00	29.59	41,442,028.37	†175.00
New York Central and Hudson River, stock.........	179,282,060.00	14,285,745.00	7.97	19,634,324.93	137.44
Northern Pacific:					
Subscription to 24,916 shares, 5 per cent paid....	....	....	......	124,580.00	......
Pacific Fruit Express, stock subscription, 10 per cent paid..................	....	....	......	1,200,000.00	......
St. Joseph and Grand Island:					
First preferred stock..	5,500,000.00	932,200.00	16 95	} 2,022,540.00	39.80
Second preferred stock	3,500,000.00	1,250,000.00	35.71		
Common stock......	4,600,000.00	2,900,000.00	63.04		
Cost of above purchases of stocks...	....	....	......	130,368,688.46	......
Cost of above-stated subscriptions to stocks.......	....	....	......	1,601,330.00	......
Total cost of investment in stocks since June 30, 1906	....	....	......	131,970,018.46	......

* 80,000 shares pledged to secure $8,000,000 par value of 4 per cent gold bonds of Railroad Securities Company.

† Plus interest. Price exclusive of dividend of $3.50 per share, or 3½ per cent of par.

The stock in the St. Joseph and Grand Island Railroad Company, described in the foregoing table, was purchased by the Union Pacific from Mr. Harriman while he was president of the company, and he declined to state when he acquired that stock and what he paid for the same. . . .

CONCLUSIONS

The effect of the control of the Southern Pacific by the Union Pacific has been to unify and amalgamate the management of these two railway companies and their steamship lines, and to eliminate competition between them in transcontinental business and in business to and from oriental ports.

The Union Pacific, as has been shown, controls the San Pedro, Los Angeles & Salt Lake Railroad, the stock of which is deposited in the hands of a trustee. This line was originally intended as an independent road, extending from Salt Lake, where it connects with the Union Pacific and with the Denver & Rio Grande, to Los Angeles and San Pedro, Cal. There is therefore no competition between this line and the Union Pacific and Southern Pacific.

It appears that the Union Pacific also owns $10,000,000, par value, of the stock of the Atchison, Topeka & Santa Fe Railway Company, and about $30,000,000 more is owned by individuals connected with the Union Pacific, making $40,000,000, or substantially 17 per cent of the entire capital stock of the Santa Fe Company. Who owns this stock, outside of the $10,000,000, Mr. Harriman declined to state. Two directors of the Union Pacific are also directors of the Santa Fe company; and there is now a division of the oriental traffic by the Pacific Mail Steamship Company between the Union Pacific and the Santa Fe systems. It appears that there has also been a division of the fruit traffic between certain California territory and the east, each taking a certain percentage; and that north of San Francisco the Union Pacific and the Santa Fe have joined and amalgamated their interests in the Northwestern Pacific Railroad, and that a joint control has been inaugurated similar to that of the Alton.

Prior to the acquisition of the Southern Pacific by the Union Pacific, the Denver & Rio Grande system, extending from Denver, where it connects with various lines to the east, to Salt Lake and Ogden, was given equal facilities over the Central Pacific, and thereby practically formed another transcontinental line. Since the amalgamation of the Union Pacific and Southern Pacific, and the construction of the San Pedro road, this line has been denied equal facilities in the receipt and transportation of freight over the Central Pacific and the San Pedro lines. Its business, therefore, has decreased, and its ability to compete with the Union Pacific and Southern Pacific impaired. On this account the Gould lines

are aiding the construction of another line from Ogden to San Francisco.

The joint control of the Alton Railway by the Union Pacific and the Chicago, Rock Island & Pacific Railway Company has undoubtedly eliminated competition between the Alton and the Rock Island between Chicago, St. Louis, and Kansas City.

These are conspicuous illustrations of the development of the theory of "community of interest" and "harmony of management," which Mr. Harriman suggested when he demanded representation upon the Santa Fe board.

If the policy of purchasing and controlling stocks in competing lines is permitted to continue, it must mean suppression of competition.

RECOMMENDATIONS

(1) The function of a railroad corporation should be confined to the furnishing of transportation. Railroads should not be permitted to invest generally in the stocks, bonds, and securities of other railway and of steamship companies, except connecting lines, for the purpose of forming through routes of transportation, including branches and feeders. It is in the interest of the public to facilitate the consolidation of connecting lines. The credit of a railway company is founded upon the resources and prosperity of the country through which it runs. Its surplus funds and credit should be used for the betterment of its lines and in extensions and branches to develop the country contiguous to it. The testimony taken upon this hearing shows that about 50,000 square miles of territory in the State of Oregon, surrounded by the lines of the Oregon Short Line Railroad Company, the Oregon Railroad & Navigation Company, and the Southern Pacific Company, is not developed; while the funds of those companies which could be used for that purpose are being invested in stocks like the New York Central and other lines having only a remote relation to the territory in which the Union Pacific system is located.

Railroad securities should be safe and conservative investments for the people. To this end the risks of the railway should be reduced to a minimum. Everyone knows that railway securities fluctuate more or less, according to the prosperity of the times, and also by reason of the wide speculation in such securities. It therefore adds an element of hazard to a railroad's capital and credit to have its funds invested in the stocks of other companies, thereby

endangering its solvency and its ability to pay reasonable dividends upon its own capital stock. It is a serious menace to the financial condition of the country to have large railway systems fail to meet their obligations or go into the hands of receivers, and the object of legislation and administration should be to lessen the risks of railway investments.

(2) It is contrary to public policy, as well as unlawful, for railways to acquire control of parallel and competing lines. This policy is expressed in the Federal laws and in the constitutions and laws of nearly every State in the Union. We have examined the constitutions and laws of all the States, and find in about forty of them prohibitions against consolidation of capital stock or franchises of competing railways, or the purchase and acquisition by a railway of competing lines. Competition between railways as well as between other industries is the established policy of the nation. And while the acquisition of a small minority of the stock of a competing line might not decrease the competition, yet the acquisition of any considerable amount of stock, with representation on the board of directors of such railway, unquestionably has the effect of diminishing competition and lessening to that extent its effectiveness. So long as it is the policy of the General Government and of the States to maintain competition between naturally competing lines, the ownership of any stock by one railway in a competing railway should not be permitted, and such lines of railway should be prohibited from having any common directors or officers.

(3) The time has come when some reasonable regulation should be imposed upon the issuance of securities by railways engaged in interstate commerce. We are aware that in the construction of new lines of railway, developing new territory, it has been necessary in many instances to sell railway securities at large discount, and to sell bonds with stock bonuses, and even in such cases it has many times been difficult to raise the necessary capital. Men will not invest their money and take the risk for small rates of interest.

But this principle does not apply to old established railway systems having good credit. Such railways should be prevented from inflating their securities for merely speculative purposes. Railroads should be encouraged to extend their systems and develop the country. It is of the utmost importance, also, that railway securities should be safe and conservative investments for the public, and should yield good and ample return for the money invested. Reasonable regulation will tend to make them safer and more se-

cure investments, and thereby benefit not only the railway companies but the public.

2. Control of Central Pacific by Southern Pacific [1]

By the Commission:

In this proceeding the Southern Pacific Company applies for authority under paragraph (2) of section 5 of the interstate commerce act to acquire control by lease and stock ownership of the Central Pacific Railway Company, a copy of the proposed lease being filed with the application. The application recites that the occasion therefor is a recent decision of the Supreme Court of the United States holding that the existing control by the applicant of the Central is prohibited by the Federal antitrust act of July 2, 1890, known as the Sherman law. This decision was rendered on May 29, 1922, in a cause entitled *United States* v. *Southern Pacific Company et al.*[2] The court directed that a decree be entered terminating the existing control and separating the properties united thereunder, subject to provisions for apportionment or joint use of certain of the lines of the respective companies to which more particular reference will be hereinafter made. The suit in which this decision was rendered was instituted in February, 1914. The issues were joined, the case tried, and the record closed before the passage of the transportation act, 1920. That act was not mentioned in the decision of the Supreme Court.

The theory of the application is that section 407 of the transportation act, 1920, amending section 5 of the interstate commerce act, contains a grant of authority from Congress to us to permit the acquisition of control of one carrier by another, by lease, stock ownership, or in any other manner not involving the consolidation of such carriers into a single system for ownership and operation, whenever found by us to be in the public interest, and expressly relieves carriers acting under such permission from the restrictions of the Sherman law and from any and all other restraints or prohibitions by law, State or Federal. It is urged that these provisions constitute a radical change in the legislative policy of Congress, in respect of the application of the Sherman law to the railroads of the country, and that they evidence a recognition on the part of Congress of the fact that the comprehensive regulation and control of interstate

[1] 76 I. C. C. 508 (February 6, 1923). See Jones, pp. 350–351, 596–597, and Vanderblue and Burgess, p. 411.

[2] 259 U. S. 214.—Ed.

carriers now vested in us renders unnecessary, for the protection of the public, the strict and inflexible application to such carriers of the prohibitions of the Sherman law and similar laws. It is contended further that there may be combinations of railroads that are in the public interest, which are legally impossible under existing anti-trust legislation, and that Congress intended to afford a means of permitting or rendering lawful a control or combination of railroads, whenever in our opinion such control or combination is in the public interest.

Approaching the situation from this standpoint, the applicant urges that the decision of the Supreme Court does not in any way preclude us from the exercise of the powers and the performance of the duties conferred or imposed by the transportation act. The applicant states further that it is its purpose to acquire *lawful* control of the Central under the later law, to the extent deemed by us to be in the public interest, to the end that the relations between the applicant and the Central may be brought into harmony with the existing policy of the law.

On October 25, 1922, the Union Pacific Railroad Company filed a petition in intervention and moved for the dismissal of the application upon various grounds which will be discussed in the course of this report. Argument was heard upon this motion on November 4, 1922. We thereafter denied the motion and directed that a hearing be held upon the application, leaving the questions raised by the motion for such disposition as might be proper in connection with our disposition of the case upon its merits.

The application sets forth various matters of fact, and evidence was adduced at the hearing in support thereof. The position taken by the applicant may be stated as follows:

The applicant is a Kentucky corporation organized in 1884, which operates a large system of rail and steamship lines, including the rail lines of the Central Pacific. The present Central Pacific Company is a Utah corporation organized in 1899, which acquired in that year all of the property of the Central Pacific *Railroad* Company. The company last mentioned was organized in 1861 under the laws of California. By 1870 it owned and operated a line from Oakland, Calif., via Sacramento, Calif., to Ogden, Utah, and in addition certain north and south lines in California, which as early as 1872 reached Goshen Junction in the south and Redding in the north. In 1870 the individuals in control of the Central Pacific acquired control also of the Southern Pacific *Railroad* Company.

At this time the Southern Pacific line extended only from San Francisco, Calif., southward to Gilroy, Calif. Additional construction by both companies continued throughout the next decade, and as lines were completed they were operated by the Central Pacific until 1885. In February of that year the Southern Pacific *Company*, the applicant in this proceeding, then recently organized, acquired control by lease of the Central Pacific lines. The new Southern Pacific Company in due time acquired the stocks of all the companies comprising the Southern Pacific System as now constituted, including the stock of the present Central Pacific Railway Company, to which the old Central Pacific *Railroad* Company had transferred all of its property as before stated.

The applicant emphasizes the long-continued relationship between the two properties and the resultant interdependent character of the transportation service afforded. It is represented that independent operation would result in the creation of approximately 20 new junction points, that division terminals, shops, and other facilities would be dislocated, and that necessary duplication of facilities would involve large expenditures. Testimony was offered indicating that independent operation would impair the efficiency of the service now offered by both companies and would lead to the disruption of established freight and passenger train service, thus destroying existing routes and channels of trade. Increases in operating expenses, and the substitution of two and three line hauls for one line hauls, in respect of a substantial volume of traffic, were cited as a reason for the conclusion that a separation of the two systems would bring about a material increase of transportation charges. It was established that the applicant is the guarantor of outstanding funded obligations of the Central Pacific amounting to $163,237,841.50, and that the applicant has outstanding collateral trust bonds amounting to $34,100,-500, secured by the pledge of $84,675,500, virtually all, of the outstanding capital stock of the Central Pacific. In addition to the guaranty, the Southern Pacific was shown to have pledged as security for Central Pacific obligations $54,193,250, appraised value, of stock, and $6,178,000, appraised value, of bonds of various companies constituting the Southern Pácific system, and that other securities have been pledged for the same purpose which have not been appraised but which are estimated to be of great value. This interrelation of obligations and the provisions of the various indentures of mortgage and pledge executed in

connection therewith would result, in the opinion of the applicant, in numerous perplexing and difficult problems if the two companies were separated, involving the rights of the holders of the obligations as well as the rights and obligations of the applicant and the Central as between themselves. Evidence was offered which tends to show that an independent Central Pacific would have difficulty in financing its capital requirements. An analysis of traffic was submitted which purports to show the maximum amount of tonnage which may be claimed to have been diverted in 1921 from the Ogden gateway by reason of Southern Pacific control. The amount thus shown was 82,663 tons, or approximately 0.74 of 1 per cent of the total Central Pacific tonnage, and 0.34 of 1 per cent of the tonnage of all Southern Pacific lines west of El Paso, Tex., and Ogden. It was testified that 75 per cent of all freight traffic and 88 per cent of all passenger traffic on the Central Pacific lines have both origin and destination west of El Paso and Ogden. Testimony was offered as to increase in tonnage handled by the Panama canal steamship lines for the purpose of showing that such competition has altered the relative importance of the southern route of the Southern Pacific as a competitor of the Ogden route.

The Railroad Commission of California, the State of Utah by its governor and attorney general, the State of Nevada by its governor and public service commission, the Arizona Corporation Commission, and many trade and civic bodies and chambers of commerce from localities served by the present unified system, intervened in support of the application. Evidence was presented on their behalf, the trend of which was to show that many difficulties and problems would result from a separation of the systems to the prejudice of the particular interests represented.

The interest of employees of the Southern Pacific system was represented by the intervention of the four national train brotherhoods and the Order of Railway Telegraphers. These offered testimony tending to show that dismemberment would interfere with seniority rights and, by reason of dislocation of runs and positions, would harmfully affect the employees who had established their homes in localities affected. It was urged, further, that the present practice of shifting employees seasonally from the Southern Pacific to the Central Pacific lines, which permits continuity of employment to junior employees, would probably no longer continue.

The Union Pacific Railroad Company alleges an interest in the matter by reason of the fact that its line from the east to Ogden forms with the railroad owned by the Central Pacific Railway Company a through transportation route between the Missouri River and San Francisco and other California points. Under the acts of Congress of July 1, 1862, and July 2, 1864, and acts amendatory thereof and supplementary thereto, commonly known as the Pacific Railroad acts, these lines are required to be operated and used for all purposes of communication, travel, and transportation, so far as the public and Government are concerned, as one connected continuous line, and must afford to each other equal advantages and facilities as to rates, time, and transportation, without discrimination of any kind in favor of or against the road or business of either, and are also authorized to consolidate with each other. Evidence was offered tending to show that, by reason of the competitive interest of its southern route, the Southern Pacific Company had countenanced practices which were prejudicial to the Ogden route, and it is urged that, since the primary interest of the applicant is in the former, by reason of the longer haul, the requirements of the Pacific Railroad acts can not be fulfilled unless the Ogden route is freed from Southern Pacific domination and control. Considerable testimony was offered for the purpose of showing that present routes afforded by the combined Southern Pacific-Central Pacific system can be maintained by apportionment or provision for joint use of various lines comprehended within the system. Evidence was also offered to show that an independent Central Pacific Railroad Company would be financially self-sustaining.

The Western Pacific Railroad Company intervened, alleging an interest by reason of its competitive line from Salt Lake City, Utah, to San Francisco Bay, and requesting that if the commission should approve the proposed acquisition of control, a condition be attached to the order requiring the Southern Pacific to enter into arrangements for additional through routes and joint rates with the intervener.

Testimony was offered on behalf of States and commercial and public bodies in the Middle West tending to show that traffic would be diverted by the Southern Pacific from the Ogden route and that various past practices of the Southern Pacific were in violation of the Pacific Railroad acts, to the prejudice of their respective communities. The State commissions of Colorado,

Idaho, Nebraska, and Wyoming and other interveners from California, Oregon, and Utah took much the same position.

The Public Service Commission of Oregon and some of the other Oregon interveners protested against any disposition of the matter which does not provide for the completion of the so-called Natron cut-off and for joint use thereof into the Willamette Valley by roads seeking entrance into the valley from eastern Oregon. The matter is now the subject of a complaint (No. 14392) in a separate proceeding, and it was requested that the same should be considered in connection with the application.

At the outset, it is requisite for us to determine to what extent the scope of our inquiry is limited by the Supreme Court's decision. We have approached this question with a deep sense of its importance. We are required under the statute to scrutinize with the utmost care all of the elements of the case upon which an ultimate finding that the proposed acquisition of control is or is not in the public interest may be predicated. Some of these elements were before the court in the other proceeding. It is certain that we must recognize the finality of a court decree upon the questions with which it deals. In this case the court directed a separation because the unified relation was hostile to the Sherman act. We must recognize as settled the fact that the relation dealt with was in violation of the Sherman act, and if that were the only question before us, we would not have any function to perform.

Paragraphs (2), (3), and (8) of section 5 of the interstate commerce act, added by the transportation act, 1920, became effective subsequent to the filing of the bill by the Government against the Southern Pacific Company, although prior to the date of the Supreme Court's decision. As our jurisdiction was not invoked until after the decision had been rendered, it is apparent that the change in the law effected by section 5 of the interstate commerce act as amended was not involved, directly at least, in the issues before the court. Carriers affected by any order made by us pursuant to paragraph (2) of section 5 are under the provisions of paragraph (8) relieved from the operation of "antitrust laws," and all other restraints or prohibitions by law, State or Federal, in so far as may be necessary to enable them to do anything authorized or required by such order. Under paragraph (2) we are given broad power to consider the questions of public interest involved in an acquisition of control by one carrier of another, and are given

authority by order to approve and authorize such acquisition, under such rules and regulations, and for such consideration and on such terms and conditions, as shall be found by us to be just and reasonable in the premises.

While the Sherman law has not been repealed, carriers affected by any order made by us under paragraphs (1) to (7) of section 5 of the act are relieved from its operation. How far our discretion in any particular case should be influenced by consideration of the evils which the Sherman law was designed to prevent is a question necessarily involved in every case where a carrier seeks to acquire control of a competing line. There is nothing in section 5, however, indicating that the Congress intended that we should refuse to accept jurisdiction upon the ground, solely, that a proposed acquisition of control would violate the Sherman law. Full effect must be given to the provisions of paragraph (8). When by our order based upon broad considerations of the public interest we in effect grant relief against antitrust laws, and other restraints and prohibitions by law, we are exercising a power which the statute gives to us alone. Evidence as to public benefits to be derived from common control of competing carriers, which would be immaterial in a prosecution under the Sherman Act, might be entirely pertinent in a proceeding before us under paragraph (2). There is, therefore, an essential dissimilarity in the issues and in the nature of the proceeding which in our opinion makes it proper for us to pass upon the application, while giving full effect to the adjudication of the Supreme Court.

The present control of the Central Pacific by the Southern Pacific is unlawful and, pursuant to the mandate of the Supreme Court, must be brought to an end by terminating the present lease and transforming the present illegal ownership of stock into a lawful ownership. The court directed an apportionment as between the two carriers of the several terminal lines and cut-offs leading to San Francisco Bay which were constructed or acquired during the unified control of the two systems or, in the alternative, that appropriate provision be made in the final decree for their joint or common use. A like course was directed with respect to the lines extending from San Francisco Bay to Sacramento and to Portland, Oreg. This establishes the status of the Central Pacific and Southern Pacific lines for the purposes of this proceeding. It is our duty to determine whether two such separate competing systems would be able to function better in the public

interest than a unified system brought about in the manner proposed by the applicant.

Another question of importance remains to be considered before we pass to the consideration of the proposal for unified operation and control. In the course of the opinion of the Supreme Court to which reference has been made it is stated:

> In our view the lease for 99 years by the Central Pacific to a rival and competitive company could not legally be made without authorization by Federal legislation. In the absence of such action the Central Pacific has not the corporate capacity to make the lease.

The court was speaking of the Central Pacific Railroad Company, which was the predecessor of the present Central Pacific, and which was organized under the laws of the State of California. The present Central Pacific is a creature of the State of Utah, and has the authority of the laws thereof and of the States in which it operates to make the proposed lease. It appears, however, that at the time the lease which was before the court was executed, the California company was authorized under the laws of California, at least, to enter into such an agreement. At all events, the court finds that authorization by Federal legislation is necessary, and its subsequent remark as to the lack of corporate capacity of the Central Pacific must be regarded as relating to the necessity for Federal authority. It is provided in paragraph (2) of section 5 that "the commission shall have authority by order to approve and *authorize*" such acquisitions of control as we may find to be in the public interest; and by paragraph (8) of that section the carriers affected by such order are relieved from all restraints or prohibitions by law, State or Federal, so far as may be necessary to enable them to do anything authorized or required by the order. Whether or not the provisions of paragraph (2) alone may be regarded as constituting a grant of authority to a carrier affected by our order to perform an act for which no other authority is claimed, it seems to us that the provisions of paragraph (8) were intended by Congress to remove all active restraints by law and grant authority so far as necessary to enable the carriers affected by our order to do anything authorized or required thereby. In *Pennsylvania Railroad Company* v. *St. Louis etc. R. R. Co.*, 118 U. S., 290, 309, cited by the Supreme Court in connection with the proposition under consideration, it was said, after a review had been made of the authorities:

* * * We think it may be stated, as the just result of these cases and on sound principle, that unless specially authorized by its charter, or aided by some other legislative action, a railroad company can not, by lease or any other contract, turn over to another company, for a long period of time, its road and all its appurtenances, the use of its franchises, and the exercise of its powers, * * *

The court thus recognizes that the necessary authority may be supplied not only by the charter of the corporation, thus granting specific authority, but by "other legislative action." We are of the opinion that the present impediment to the lease by the Central Pacific of its lines is such a restraint as has been removed by paragraph (8) of section 5 as to carriers affected by our order of approval and authorization. Even if the question were doubtful, we should consider it our duty to proceed with a consideration of the unification plan upon its merits. We are an administrative body charged with the determination of the public interest. Any order we may make herein is subject to review upon the question under discussion.

The hearing held upon the application extended over several weeks, and a voluminous record has been made. The salient features thereof have already been outlined. It may be taken as established that the Central Pacific Railway between San Francisco and Ogden, and the Union Pacific Railroad between Ogden and Omaha, Nebr., and Kansas City, Mo., with the eastern connections of the latter road, form a system of transportation which affords the most direct and normal route for a large volume of traffic between the East and the West. The same may be said also of the southern route over the Southern Pacific lines. In contrast, the Southern Pacific and Central Pacific lines running north and south in California and Oregon with their branches afford, generally speaking, a service of an essentially different character, consisting of heavy local passenger and freight service and the gathering and delivery of freight for the transcontinental carriers with which such lines connect. The latter element of the service thus performed is as valuable and necessary in the maintenance of present standards of service on the Ogden route as it is to the southern route. From this point of view, the use by the Central under unified management of Southern Pacific lines for gathering and delivery of freight is as important to the Central as the corresponding use made by the Southern of Central lines is to the Southern.

The record justifies the conclusion that separate operation of the Central Pacific lines will disrupt existing routes and service in California and between that State and adjacent States, and except to the extent that the rupture may be mitigated by apportionment of particular lines and provision for the joint or coordinated use of others by the respective carriers, will render impossible the continuance of much valuable transportation service now conducted over the Central Pacific and Southern Pacific lines without regard to corporate ownership. Such separation will result to an indeterminate extent in increased cost of operation and duplication of capital investment in railroad facilities and increased cost of transportation. Moreover it is doubtful whether for a time, at least, the Central Pacific, if operated as an independent carrier, would have the earning capacity, credit, and financial ability to sustain the heavy burden of its fixed charges and provide the new capital for its equipment and improvement necessary in the future to meet the requirements of the public service. Indeed, there are reasons for grave doubt whether the interests of the country as a whole would not be adversely affected by the financial problems and results consequent upon such a separation. There is a large volume of traffic having origin or destination on rails controlled by the Southern Pacific Company in central and northern California, not reached by rails of the Central Pacific, and originating in or destined to territory in the East or Middle West, for which the shortest and most economical transportation route is the Central Pacific-Union Pacific route via Ogden. As a practical matter, and in the absence of joint rates or joint use of the lines now existing, access to such points of origin or destination in California can be had by the Central Pacific only by construction of branches and extensions at very great cost, which would involve a wasteful duplication of railroad facilities. To the extent that such traffic might, in the event of a separation of the Central Pacific and Southern Pacific, be secured by the Southern Pacific for transportation over the southerly routes via El Paso in which it participates, the distance, time, and cost would be greater than via the Ogden route, with attendant prejudice to the public interest. On the other hand, the routing of such traffic over the Central Pacific-Union Pacific route via Ogden will be in the interest of those lines, which were created by Federal authority and Federal aid, and will be in accord with the purposes of the Pacific Railroad acts.

It remains to be considered whether these evils can be lessened

or removed altogether by the apportionment of particular lines to one carrier or the other, or by providing for the joint or common use of lines strategically located. In the decision of the Supreme Court to which reference has been made, it is directed that the decree severing the present control shall provide for such apportionment, or the joint or common use, of the several terminal lines and cut-offs leading to San Francisco Bay which have been constructed or acquired during the unified control of the two systems, to the end that both companies may have such full, convenient, and ready access to the bay and to terminal facilities thereon that each company will be able freely to compete with the other, to serve the public efficiently, and to accomplish the purpose of the legislation under which it was constructed. A like course was directed with respect to the lines extending from San Francisco Bay to Sacramento and to Portland. The decree accomplishing this purpose has not been entered, but we have considered the various ways in which the directions of the Supreme Court might be effected. We entertain no doubt that such arrangement would be practicable, and we are of the opinion that if the two companies entered fairly into the spirit of the Supreme Court's mandate, many of the disadvantages to which we have alluded as arising out of separation would be eliminated or mitigated. On the whole, however, we are convinced that even if everything of this nature which can be done were done, the result would be more expensive and less efficient and satisfactory service than can be rendered under unified control. The two systems would be weakened both financially and from the standpoint of service. In the course of time this situation might find partial remedy, but in many respects no remedy would be possible.

We are thus brought to the consideration of whether it is possible to authorize the proposed acquisition of control subject to conditions which will remove the opportunity otherwise existing in the Southern Pacific to restrict competition or fetter the free and normal flow of interstate traffic by reason of its control of two competing transcontinental routes, and will adequately protect the rights of the Union Pacific and all interests of the public under the Pacific Railroad acts. On January 3, 1923, before arriving at any conclusion, on suggestion to us by parties before us, we sent a memorandum to persons who had intervened or filed appearances in the proceeding, requesting that expressions be made regarding the arrangement to be sanctioned and required in case

the decision of the commission should be favorable to the applicant's proposal, and asking for specific consideration of the effect of an order of approval made subject to the following conditions:

First. The Southern Pacific shall join with the Union Pacific in maintaining via the lines of said companies between Omaha, Nebr., and San Francisco Bay points as parts of one connected continuous line through passenger, mail, express, and freight train service between San Francisco or Oakland, Calif., and Chicago, Ill., at least equal in every respect to that afforded by either with its connections between Los Angeles, Calif., or Portland, Oreg., and Chicago, Ill.

Second. The Southern Pacific shall join with the Union Pacific in maintaining via the lines of said companies between Roseville, Calif., and Omaha, Nebr., as parts of one connected continuous line perishable freight train service from Roseville, Calif., to Chicago, Ill., at least equal in point of time to that afforded by either with its connections from San Bernardino or Colton, Calif., to Chicago, Ill.

Third. The Southern Pacific shall cooperate with the Union Pacific in the maintenance of train schedules under which neither shall discriminate as to time or service against the other in favor of any other connection through Ogden or Salt Lake City.

Fourth. The Southern Pacific shall, at the request of the Union Pacific, provide for the publication and maintenance of rates via the Central Pacific through Ogden between all Southern Pacific and Central Pacific points in California west of Banning, and Oregon on the one hand, and Colorado common points and points east thereof on the other, no higher than apply concurrently between the same points via any other route in which it participates. While the Commisson may have no power to impose any conditions upon the Union Pacific in this proceeding, it is suggested that the same course should be pursued by the Union Pacific in connection with rates between the same points via its various routes.

Fifth. The Southern Pacific shall cooperate with the Union Pacific to secure by active solicitation the routing of the maximum of freight traffic via Union Pacific and Central Pacific lines through the Missouri River and Ogden as parts of one connected continuous line between all points in California, north of and including Caliente, and Santa Margarita (including points in Oregon on the Klamath Falls Branch, Kirk and south) on the one hand, and points north and west of a line along the northern boundaries of Oklahoma and Arkansas to the Mississippi River, thence via the Mississippi and Ohio Rivers (but not including intermediate cities on the Ohio River) to Wheeling, W. Va., thence north on a line drawn just east of Pittsburgh and Buffalo to Niagara Falls.

We have received replies from practically all of the interveners. The vast majority, including State commissions or other authori-

ties of Arizona, California, Colorado, Nebraska, Nevada, Utah, and Wyoming, were distinctly favorable to an order of approval upon the conditions suggested. Many interveners who had previously objected strenuously to the granting of the application regarded the conditions as sufficiently safeguarding their interests. Practically no objection was made to the conditions themselves, but certain interveners suggested that other elements of public interest should be safeguarded by additional conditions, as follows:

1. An intervener from St. Louis, Mo., approved the plan generally but contended that St. Louis should be given the same rights to through connected service which are insured to Chicago by the first condition and that some provision should be made in the order which would preclude the possibility of closing the Ogden gateway to any line east thereof.

2. The Public Service Commission of Oregon and certain other Oregon interveners contended that our order of approval should provide for the completion of the Natron cut-off into the Willamette Valley and for the joint use thereof by roads seeking entrance into the valley from eastern Oregon. The Senate of the State of Oregon has requested by a memorial that we should dispose of the application only after full inquiry into all facts touching upon the needs of railroad development within the State of Oregon, its resources and possibilities, and the rights of its citizens for further immediate railroad development and adequate railway service.

3. Two commercial associations in Chicago, while approving of the plan generally, urged that the obligation as to service and participation in rates via the Ogden gateway, imposed upon the Central Pacific and the Union Pacific, should apply also to all other lines which now are or may hereafter be connections of the Central Pacific at Salt Lake City or Ogden.

The Southern Pacific has stated as its position that it will accept and abide by the five conditions set forth in our memorandum of January 3, 1923, if included in our order. The Union Pacific has approved of the conditions and expressed its view that the same will secure adequately the rights claimed by it under the Pacific Railroad acts.

As to the objections made by the St. Louis and Chicago interveners, it should be observed, first, that we have no jurisdiction in this proceeding to enforce an order against the Union Pacific or carriers other than the applicant and the Central Pacific. The Union Pacific, however, has accepted and approved the conditions

made, as they apply to the applicant and its constituent lines, and has evinced its intention to comply therewith so far as its cooper-eration is necessary or required. The standard of service prescribed by the first condition is intended merely as a criterion by which to determine in the future whether any discrimination is practiced in the particulars mentioned against the Ogden route. To broaden the conditions so as to include other points would defeat its purpose, inasmuch as it would make the criterion so vague as to be of no practical value. The service covered by the first condition would pass through Missouri River territory, where it would connect with lines reaching St. Louis. The practical effect of the condition, therefore, is that the benefits thereof inure as much to St. Louis as to Chicago. At all events the condition is not to be taken as justifying any discrimination in favor of Chicago against other points, or in favor of any carrier and against any other.

The Southern Pacific upon the oral argument definitely committed itself to the maintenance of an open gateway at Ogden, and counsel for the Missouri Pacific Railroad and for the Denver & Rio Grande Western Railroad, the carriers most immediately concerned with this question, stated that if this were done the rights of those companies would be safeguarded. Furthermore, we have broad powers under the act in the matter of the establishment and maintenance of through routes and joint rates, and nothing here done will prejudice our right to exercise such powers in the future as occasion may require.

We have given consideration to the position taken by the Oregon Public Service Commission and other Oregon interveners who urge that the issues raised by the complaint of the Public Service Commission against the Southern Pacific Company and others with respect to the Natron cut-off be considered in connection with this proceeding. In our opinion such issues are not so connected with the present issues that it would be proper for us to pass upon them now. We are not convinced that the many benefits to be derived from the proposed acquisition of control should be held in abeyance pending termination of the proceedings under the complaint mentioned. Relief appropriate to such complaint will be granted in due course, if justified by the facts presented, and nothing herein decided will of necessity limit the scope of such relief. Moreover, it appears that the Southern Pacific Company has agreed, in part at least, to the contentions made by the interveners from Oregon and that the construction of the Natron cut-off will

be commenced in the near future. The cut-off has been a part of the Southern Pacific's construction program for a long time. It is represented that, in view of the suit by the Government to separate the Southern Pacific and Central Pacific, and the resultant uncertainty of the title of the respective companies in their properties, it was deemed unwise to incur the large expenditure, about $10,000,000, necessary to complete the project. It appears that the board of directors of the Southern Pacific has formally declared its intention to proceed immediately with the completion of the work in the event that the right of the Southern Pacific to hold the Central Pacific should be confirmed. Counsel for the applicant, upon the oral argument, stated the following:

> So far as we may be bound by anything, we are bound by that declaration of policy and by that resolution of the board of directors, which we regard upon our side as a contract with the people of the State of Oregon for the completion of that line.

We have taken note of these assurances. We believe that they are made in good faith and, for the present, deem it best to leave with the applicant the initiative in this important work.

The Western Pacific Railroad Company has withdrawn its request that our order contain a provision requiring the Southern Pacific to enter into arrangements for additional through routes and joint rates with lines of railroad competitive with the lines now owned by the Central Pacific Railway Company. It was stated in its behalf upon the oral argument that a satisfactory adjustment had been reached with the Southern Pacific. . . .

By virtue of the Pacific Railroad acts the Union Pacific and Central Pacific have certain reciprocal rights, including the right to cooperation in the establishment and maintenance via the Central Pacific-Union Pacific route of through train service and joint rates reasonably necessary to meet competition by other routes, and to cooperation in other respects, to the end that the lines of said companies shall be operated and used as one connected, continuous line. We think that the rights of the Union Pacific and all interests of the public under the Pacific Railroad acts may be protected by imposing upon the acquisition and exercise of control by the Southern Pacific Company of the Central Pacific the five conditions set out above. We think also that these conditions will so correct and remove any suppression of the normal flow of traffic over the Ogden route that the public interest generally will adequately be pro-

tected; and that they will bring about, in connection with transcontinental traffic, a situation as favorable to the public from a traffic and service standpoint as though the Central Pacific were to remain free from Southern Pacific control. The acquisition of control as proposed, subject to these conditions, will also prevent the evils already adverted to, as incident to separation.

The extent of the control asked by the Southern Pacific Company of the Central Pacific Railway Company in the application is as follows: *(a)* By lease until December 31, 1984, subject to termination by our order if and when found by us to interfere with the consummation of the final plan of consolidation when promulgated under section 5 of the interstate commerce act as amended; and *(b)* by ownership of all of the outstanding capital stock of the Central Pacific Railway Company during the continuance of such lease. We deem it in the public interest that the applicant should be restricted from voluntarily disposing of the capital stock of the Central Pacific Railway without our approval, and further, that the lease should by its terms become null and void and of no effect if and when the control herein sought is found by us to interfere with the consummation of such plan of consolidation.

The question has been raised as to whether an acquisition of control under the circumstances proposed amounts to a consolidation of the carriers concerned "into a single system for ownership and operation," as to which type of control we have no jurisdiction under paragraph (2) of section 5. We have given consideration to the question and find that an acquisition of control consummated as proposed and exercised subject to the conditions to be imposed by our order herein, does not involve the consolidation of such carriers into a single system for ownership and operation. It is not enough to constitute such a consolidation that the carriers or their properties be consolidated into a single system for operation, or for management, or for management and operation, but it must also appear that they are consolidated for ownership. Since each of the carriers will retain its corporate identity and the legal title to its property, no consolidation of the kind defined by the statute will result.

Upon the whole record we find that the acquisition of control of the Central Pacific by the Southern Pacific Company, by lease and stock ownership as asked in the application, will be in the public interest, provided that the foregoing terms and conditions be imposed upon such control and the exercise therof, and said terms

and conditions are hereby imposed and the Southern Pacific Company is directed to observe the same so long as such control shall be exercised by it pursuant to our authority.

An appropriate order will be entered.

MEYER, *Chairman,* concurring.

Whatever the objections may be to the inclusion of conditions relating to a project more or less foreign to the subject matter of the proceeding, in view of the representations made by the applicant, upon this record, a condition requiring the construction of the Natron cut-off might properly be included in the order.

COMMISSIONERS AITCHISON and CAMPBELL join me in this expression.

EASTMAN, *Commissioner,* concurring:

In *Control of Big Four by New York Central,* 72 I. C. C., 96, I expressed the following view, at page 100:

> It is conceded that the New York Central and the Big Four are now a single system for operation. In my judgment they will also be a single system for ownership if the New York Central acquires 100 per cent of the Big Four stock, and virtual consolidation into one corporation for ownership, management, and operation will have taken palce. No other conclusion can be reached, unless form be deemed of more significance than substance.

While the order herein authorizes the Southern Pacific to acquire control of the Central Pacific not only by lease but through ownership of all the latter's stock, the control differs from that authorized in the Big Four case, since the order provides—

> that the control herein authorized by lease and stock ownership shall be held subject to termination by order of the commission if and when found by this commission to interfere with the consummation of its complete plan of consolidation under the provisions of section 5 of the interstate commerce act * * *.

Control held subject to such a contingency differs essentially, it seems to me, from that authorized in the Big Four case.

In the majority report the statement is made "that the present impediment to the lease by the Central Pacific of its lines is such a restraint as has been removed by paragraph (8) of section 5 as to carriers affected by our order of approval and authorization." I

doubt the accuracy of this statement, but in view of the fact that the order entered is subject to court review upon this question I am willing to join in approval of the order.

CAMPBELL, *Commissioner*, concurring in part:

I am in accord with the majority report to the extent that it finds the control of the Central Pacific by the Southern Pacific to be in the public interest. But I am unable to concur in the order which fails to recognize the mandate of the Supreme Court of the United States issued and filed in the District Court. The Supreme Court having found that—

> In our view the lease for 99 years by the Central Pacific to a rival and competitive company could not legally be made without authorization by Federal legislation. In the absence of such action the Central Pacific had not the corporate capacity to make the lease;

the issue as to the capacity of the Central Pacific to make a lease, to my mind, is *res adjudicata*. In my opinion the transportation act, 1920, being general in nature, did not remedy this defect of corporate power, but in view of the record made in this case and in order not to run counter to the Supreme Court's mandate, the effectiveness of our order should be made contingent upon the submission of our findings herein to the District Court and approval by the Supreme Court.

MCCHORD, *Commissioner*, dissenting:

Under section 5 of the interstate commerce act, as amended by the transportation act, 1920, we are given power to approve and authorize, if we deem it to be in the public interest, the acquisition of control of one carrier by another in any manner not involving the consolidation of such carriers into a single system for ownership and operation. A finding by the Supreme Court of the United States that an essentially similar control heretofore exercised by the applicant was and is unlawful because it is in violation of the Sherman Antitrust Act of July 2, 1890, is not in itself a bar to the exercise by us of the powers granted under said section 5. If that were all that is involved in this case, I would be in agreement with the majority.

I am of the opinion, however, that the findings of the majority are not only contrary to the will of Congress as expressed in the same legislative act which conferred the powers invoked in this

case, but are impossible of fulfillment in view of the decision of the Supreme Court with respect to the lack of corporate authority in the Central Pacific to make a lease of its Federal franchises.

Congress in authorizing us, in the same section 5 to prepare and adopt a plan for the consolidation of the railway properties of the continental United States into a limited number of systems required that, "in the division of such railways into such systems under such plan, competition shall be preserved as fully as possible." The power under paragraph 2 of section 5 to approve and authorize the acquisition of control of one carrier by another in a manner not involving consolidation as therein specified, was obviously thus limited so that the general plan of consolidation might not be forestalled. It seems to me that the limitation placed upon the consolidation plan itself with respect to the preservation of competition, should be accepted and applied to any authorization we may make involving the control of one carrier by another, in order that the competition about which Congress was solicitous may not be destroyed. I make this observation because the conditions prescribed in the majority report in the instant case, very greatly curtail, in my opinion, the possibilities of competition in services and rates between the carriers involved. For this reason I can not assent to the report.

But even if it be considered not to run counter to the purpose of Congress the authorization runs counter to an express finding of the Supreme Court that the lessor, the Central Pacific, was without corporate capacity to make such a lease. The court in *United States* v. *Southern Pacific Co.*, decided May 29, 1922, said:

> It is true, as is argued as length by counsel for defendants, that Congress had opportunity, by the reports of its committees and otherwise, to learn of this lease; but we are referred to no legislation passed by Congress authorizing or approving of it. In our view the lease for 99 years by the Central Pacific to a rival and competitive company could not legally be made without authorization by Federal legislation. In the absence of such action the Central Pacific had not the corporate capacity to make the lease.

The court was not of course referring to the lease upon which the Southern Pacific is now asking us to authorize its acquisition of control of the Central Pacific. The legal incapacity is still there nevertheless. The language of the court leaves no room for doubt upon that point. We, like the court, "are referred to no legislation passed by Congress authorizing or approving of it."

Does section 5 of the act, as amended, supply the essential legislation? The majority adopts the view that it does, but with this finding I can not agree. The phrase "other restraints or prohibitions by law, State or Federal," which is found in paragraph (8) of section 5 is the phrase relied upon, but these restraints or prohibitions are clearly intended by Congress to mean all restraints or prohibitions of the character contemplated by anti-trust and similar restrictive and prohibitory laws. This legislation does not, therefore, supply the corporate capacity which the Supreme Court said was lacking. In other words, carriers whose property is to be acquired under lease must necessarily have the legal capacity to make the lease and the want of such capacity is not one of the restraints or prohibitions by law, State or Federal, contemplated by paragraph (8) which may be removed by virtue of our order.

I am of the opinion that in view of the finding of the Supreme Court we should find that the lease may not be made by the Central Pacific and deny approval and authorization of the Southern Pacific's application to acquire control under such a lease. . . .

CHAPTER XXIV

CONSOLIDATION UNDER THE TRANSPORTATION ACT OF 1920 [1]

1. Controlling Principles [2]

The transportation act of 1920 deals with the consolidation of railways into systems by the amendment of section 5, paragraph (4) of the act to regulate commerce, of 1887, making it read as follows:

The Commission shall as soon as practicable prepare and adopt a plan for the consolidation of the railway properties of the continental United States into a limited number of systems. In the division of such railways into such systems under such plan competition shall be preserved as fully as possible and wherever practicable the existing routes and channels of trade and commerce shall be maintained. Subject to the foregoing requirements, the several systems shall be so arranged that the cost of transportation as between competitive systems and as related to the values of the properties through which the service is rendered shall be the same, so far as practicable, so that these systems can employ uniform rates in the movement of competitive traffic and under efficient management earn substantially the same rate of return upon the value of their respective railway properties.

The act to regulate commerce, of 1887, is further amended as to procedure in effecting consolidation by the following paragraphs of section 5:

When the Commission has agreed upon a tentative plan it shall give the same due publicity and upon reasonable notice, including notice to the Governor of each State, shall hear all persons who may file or present objections thereto. The Commission is authorized to prescribe a procedure for such hearings and to fix a time for bringing them to a close. After the hearings are at an end the Commission shall adopt a plan for such consolidation and publish the same; but it may at any time thereafter, upon its own motion or upon application, reopen the subject for such changes or modi-

[1] See Vanderblue and Burgess, pp. 410–434, and Jones, pp. 554–556, 593–596.

[2] *Consolidation of Railroads*, 63 I. C. C. 455 (August 3, 1921). Our excerpt is from the report of Professor William Z. Ripley to the Commission; and begins at p. 475.—Ed.

fications as in its judgment will promote the public interest. The consolidations herein provided for shall be in harmony with such plan.

It shall be lawful for two or more carriers by railroad, subject to this Act, to consolidate their properties or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership, management, and operation, under the following conditions:

(a) The proposed consolidation must be in harmony with and in furtherance of the complete plan of consolidation mentioned in paragraph (5) and must be approved by the Commission.

(b) The bonds at par of the corporation which is to become the owner of the consolidated properties, together with the outstanding capital stock at par of such corporation, shall not exceed the value of the consolidated properties as determined by the Commission. The value of the properties sought to be consolidated shall be ascertained by the Commission under section 19a of this Act, and it shall be the duty of the Commission to proceed immediately to the ascertainment of such value for the properties involved in a proposed consolidation upon the filing of the application for such consolidation.

(c) Whenever two or more carriers propose a consolidation under this section they shall present their application therefor to the Commission, and thereupon the Commission shall notify the Governor of each State in which any part of the properties sought to be consolidated is situated and the carriers involved in the proposed consolidation of the time and place for a public hearing. If after such hearing the Commission finds that the public interest will be promoted by the consolidation and that the conditions of this section have been and will be fulfilled, it may enter an order approving and authorizing such consolidation, with such modifications and upon such terms and conditions as as it may prescribe, and thereupon such consolidation may be effected, in accordance with such order, if all the carriers involved assent thereto, the law of any State or the decision or order of any State authority to the contrary notwithstanding.

The spirit and intent of this legislation, as well as the manner in which it was anticipated that its ends would be attained, are significant. The sections above cited do not stand alone. They are integrally related to section 15a, paragraph (2), of the act to regulate commerce, as amended, which prescribes a new statutory rule of rate-making. The statute reads as follows:

In the exercise of its power to prescribe just and reasonable rates the Commission shall initiate, modify, establish, or adjust such rates so that carriers *as a whole (or as a whole in each of such rate groups or territories as the Commission may from time to time*

designate) will, under honest, efficient, and economical management and reasonable expenditures for maintenance of way, structures and equipment, earn an aggregate annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation. [Italics mine.]

This new rule seeks to fix rates, not for any single carrier, but for the carriers by natural groups. By far the larger proportion of the traffic of the United States is carried by so-called strong or prosperous roads. But it is equally true that a large amount of mileage is in the hands of corporations which, in a financial sense, may be denominated chronically weak. The causes for such weakness are various, including disadvantageous location, unwise investment or administration, an unwieldy financial structure, or even downright impairment of capital by waste or fraud. But, regardless of the sources of this disability, these weak lines are as essential to the welfare of the communities which they serve as are the strong lines to their patrons. It is the theory of this legislation that the railways must be considered as a whole, group by group, fixing by means of the new statutory rule of rate making, a general level of return adequate to maintain them all at a proper pitch of efficiency. The difficulty in the past, as stated by Senator Cummins on December 2, 1919, in Congress, is that "It has been utterly impossible for any body of men to make a system of rates that will sustain the weaker railroads of the country without giving to the stronger railroads an income excessive and intolerable in its extent; and there lies the great fundamental obstacle in our system of rate making. * * * It was obvious, I think, to the students of the subject, long before the government took possession, that we must adopt some plan that would remove this inherent fundamental difficulty." The section of the act dealing with consolidation into systems, above cited, was intended to supplement the new sections dealing with statutory definition of reasonable rates, in coping with this difficulty.

To this end, the Senate bill sought to reduce the carrier corporations to a common denominator of earning power in terms of valuation by compulsory consolidation. It was intended to compel the stronger roads to merge their identity with the weaker ones for the common good of the country as a whole. But the measure ultimately emerged from conference committee with the procedure as above described, in place of compulsion. It was evidently

expected that the new statutory rule of rate making would afford an incentive sufficiently powerful to induce the strong companies to merge with weaker ones, rather than to be compelled to pay over their surplus earnings above the rate of return fixed as reasonable, into a revolving fund for the general benefit of their respective groups. An incentive to the weaker roads might also conceivably obtain. The aid extended by the act from the surplus earnings of the strong roads consists merely of advances or loans, except in so far as a better balanced opportunity yields larger earnings. Or else possibly a fairer administration of the division of through rates may help. But the weaker roads are encouraged to seek shelter through affiliation. They are not taken care of by any definite guaranty of earnings. But the motive for consolidation, it was held, should not be permitted to bring about indiscriminate mergers, regardless of natural relationships of the carriers either to one another, or to the needs of their respective territories. It was in order that there might be consonance between such mergers as took place and the public welfare, rather than that mere immediate profit to those concerned might result, that the formal procedure as above described was enacted into law. Not otherwise, thus, than in its direct relationship to the fundamental principle of the new act can the significance of the particular consolidation provisions be understood. And it is because of this causal relationship that the act further prescribes that no mergers which are not in accordance with this plan, as thus adopted, may lawfully take place.

As to procedure in undertaking this investigation, the leading paragraph of the statute, dealing with consolidation, above quoted, contains three requirements which must be observed. The first is that competition, presumably in service, shall be preserved; the second is that existing routes and channels of commerce shall not be disturbed; and the third, subject it will be noted, to the foregoing requirements, is that the financial aspects of such mergers shall be kept in view. Without having regard to the fundamental principle involved, both in consolidation and the new statutory rule of rate making, it might appear that these several requirements were stated in the order of their importance; in other words, that the element of financial strength was less significant than the preservation of competition and of the existing traffic routes. But having due regard to the matter in its larger practical aspects, it is evident that any plan adopted will not only

be a mere paper plan, ineffectual and futile, but that it will fail to conform to the spirit of the act, unless the financial requirements be given equal weight with those of operation and traffic. For the plan will never be put into effect unless a financial motive for consolidation be afforded; and unless it is put into effect, a positive bar to the attainment of uniform reasonable rates, under which all the carriers alike may thrive, will continue to exist, if the underlying principle of the legislation is in reality sound.

Assuming the three requirements for consolidation to be of equal importance, two quite distinct methods of approach might be adopted according as one began at the operating and traffic end, or, on the other hand, began with the financial aspects of the matter. Under normal conditions these two methods seemingly promise results of equal value. One might, presumably, first ascertain the relative financial standing of the corporations; and thereafter check up the alliances thus indicated, by applying the test of operating efficiency and satisfaction of the traffic needs of the territories concerned. Or, contrariwise, one might first seek the natural alignment of these properties as operating and traffic units, before inquiry as to whether such alignment contained an effective invitation to merger, based upon considerations of earning power and financial stability. The former method appeals particularly to financial students of the subject. It has resulted in the formulation of several significant proposals. The latter calls for a somewhat wider range of information, dealing not alone, as it does, with the operating and traffic characteristics of the carrier companies, but also looking to the broader considerations of the traffic needs of the entire communities served. For it is held that the maintenance of the "existing routes and channels of trade and commerce" implies not the preservation of merely artificial currents and conditions, but that the statute contains an invitation to consider these carrier corporations in their basic relationship to the welfare, present and prospective, of the country. Viewed in this larger sense the act is at once an invitation and an opportunity. It calls for an analysis of the commercial geography of the United States, in its relation to the layout of its railway net. For, unless the location of its railways conforms to the commercial requirements of the country, there can be no permanent prosperity for either. The further requirement in the act for a certificate of public exigency for proposed new construction of railways is but another expression of this intent in the law.

As to procedure, also, it has been represented stoutly that this plan should confine itself strictly to broad outlines; and even, perhaps, merely propose but a statement of principles. It is contended that useless complications and prejudice to future negotiations, as well as a dangerous effect upon market values, may result from descent into detail. Fully conceding the force of this reasoning, experience demonstrates that general principles and broad outlines may only be tested, as to their feasibility, by tentative elaboration of the finer points. Only thus are the thousand and one complications rendered appreciable to the naked eye. In brief, general principles and broad treatment require the test of practicability. If, therefore, it appears at times that these proposals descend unduly into the intricacies of corporate relationship, it should be borne in mind that the purpose is not so much to reach a final judgment, as it is to reveal the various considerations upon the basis of which such final decision may at some time perhaps have to be rendered.

Certain statistical data have been compiled and are incorporated in this text, as well as appended as exhibits, in order to check up the plan, as proposed, by territories and by systems, respectively. The calendar year 1917 has been chosen for the purpose, largely because the results for that period most closely approximate the standard requirement established by the statute of an operating income amounting to 5.5 per cent of the investment in road and equipment. For 1917, the actual rate of return was in fact 5.45 per cent. The tables and exhibits, as prepared by the bureau of statistics of the Interstate Commerce Commission, are necessarily confined to a few pertinent items. Among these are investment in road and equipment, total and per mile of line; revenue ton-miles; revenue per ton-mile; and railway operating revenue, total and per mile of line; net operating income, total and per mile of line; mileage operated; and percentage of net operating income on investment in road and equipment. It should be noted that the net operating income, however, is not that of the calendar year 1917, but is based upon the standard return—that is to say, the average annual net railway operating income for the three years ended June 30, 1917. The reason for using the average income (standard return) for the three years for purposes of comparison with the property investment as of December 31, 1917, is that this figure was provided by Congress as the fair rental (subject to correction) for the property actually taken over

at the close of 1917. This standard return for some roads in process of rapid development is considerably less than the actual income of the calendar year 1917. But for other roads the standard return will be found to exceed the 1917 income. The net result is that for class-I roads as a whole, the 1917 income exceeds the standard return by about 7.5 per cent. Thus it appears that for a few roads, perhaps undergoing rapid development, the standard return understates the case; but for all of the rest, the three-year average affords a safer basis than the results of any single year.

The foregoing data for class-I roads, including their subsidiaries, as segregated by systems set up under this plan, afford a rough indication of the competitive strength, geographical scope, and inherent financial stability of the relationships proposed. But it is evident that such data constitute merely a rough check upon the plan. The figures are no more to be trusted implicitly than are seductive maps nicely fashioned to produce the effect of symmetry upon paper. Such symmetry, until it be checked up and tested in detail for all manner of traffic and operating conditions, may be grossly misleading. Statistics, as well as maps, under these given circumstances must be regarded and treated as imperfect criteria. The realignment of properties, with the consequent disturbance of all traffic, is bound to be instantly reflected in earning power. The putting together or dismemberment of individual properties may bring about results which are quite unpredictable by the arbitrary means of statistical investigation. Elaborate calculations by experts concerning the development of business under the new conditions are really necessary in order to afford a reliable forecast. Not published statistics, but rather an intimate acquaintance with local traffic conditions afford the only entirely reliable data. Yet inasmuch as these data are the best we have, they are analyzed and published for what they are worth.

This consolidation plan, it should be noted, has thus far been concerned only with class-I roads; that is to say, roads having an operating revenue in excess of $1,000,000. The aggregate mileage of these class-I roads herein consolidated in 1917 was 220,000 miles. There thus remains the not inconsiderable aggregate of 39,000 miles of line, consisting of the so-called short lines, the remaining class-I roads, and those within classes II and III. That the number of these is quite large is evident from inspection of

section C of the Annual Report on the Statistics of Railways for 1917, pages 469 et seq. No attempt has been made to trace the natural relationships of these minor properties, and probably it is not necessary at this time. But the fact of their existence and of, in many cases, their grave necessities may not be ignored. A comprehensive plan of railroad consolidation would include their allocation in due course; but the data are not at present available. The case of the Illinois Traction Company, with its widespread interstate ramifications is typical of a number of other electric public utilities. No attempt is made to assign them in this tentative plan, which confines its attention solely to the larger steam roads. . . .

What test shall be applied in order to ascertain competitive ability; that is to say, ability to prosper reasonably along with other railroads in the same group under a uniform set of rates? Do the requirements of the statute call for the creation of systems of substantially equal mileage or enjoying much the same volume of gross earnings or net income from operation? Shall one seek to construct comprehensive groups conforming to one or several of these standards, or may one assume that size, as thus indicated, is merely of secondary importance? It has been urged with some cogency that this plan does not call for widespread disturbance of existing relationships except to take care of the properties that are either well above par or substantially below it. In other words, it has been urged on behalf of several properties of moderate size that they are already doing fairly well under the statute, conforming to the requirements and enjoying the reasonable return fixed by the Commission without further alliance with other companies. One has to decide as to such claims, and particularly must one decide where to draw the line in the search for uniformity in magnitude. Deciding roughly, as one must under existing conditions, it is held to be more important to create self-sustaining systems as to earnings derived from as large a proportion as possible of the area of the several great subdivisions of the country, rather than to attempt to put these properties together in such an exact way that they shall all have approximately equal mileage or equal gross or net earnings within each group. Neither mileage nor volume of business is the real test of ability to exist under the statute. In brief, as illustrated by trunk line territory, it is held that a Baltimore & Ohio system adequate to satisfy the requirements of the statute may be created by giving it a mileage

or a gross volume of traffic by no means commensurate with either the New York Central or the Pennsylvania. Its ability to serve may perhaps be dependent upon quite other considerations than those of size. If quality can be conferred by means of better developed traffic relationships, and if natural alignment and relationship can be adhered to, it is believed that the situation so far as the act is concerned will be satisfactorily met.

The dynamic aspect of consolidation must also be kept in mind. The purpose being to promote a more evenly balanced competition, especially by means of equalization of opportunity in originating traffic as well as in its interchange and delivery, it is conceivable that congestion may be in a measure relieved by this plan. The growth of business in future years must accrue largely to the existing stems. Sound public policy demands that this growth should be so distributed as to avoid blockades and embargoes on the strong roads, while the weak ones are coincidently drifting toward starvation. To insure a larger proportion of the increment to the weaker roads, by rendering them more capable of efficient service, is the idea. The purpose of the legislation being not to guarantee an income but to afford an equality of opportunity to earn it, was intended to be promoted by this means.

Fundamental differences between various plans proposed for consolidation arise concerning the size and scope of the mergers. Shall they be continental in range, reaching, that is to say, clear across the country, from east to west, and from Canada to the Gulf; or shall they conform to territorial divisions of the country? Considerations of operating efficiency and of conformity to the traffic needs of the country, as well as preservation of competition and of the established channels of trade and commerce, are not sufficient. It is essential also that administrative organization both within the company and in its relations to the government should be likewise comprehended. Particularly is it important that correspondence be maintained between the scope of these railroad systems and the long-standing rate-making areas and statistical divisions which have commended themselves upon the basis of long experience to the parties concerned. All of these considerations join in commending a division of the country for purposes of consolidation primarily into the great subdivisions of trunk line territory; southeastern territory, that is to say, south of the Potomac and Ohio rivers and east of the Mississippi; and western territory, lying beyond the Mississippi. Furthermore,

local peculiarities and the marked individuality of certain areas seem to make it desirable to set off certain subdistricts within these great primary divisions. Thus New England and Chesapeake Bay or Hampton Roads territory, and a sector between St. Louis-Kansas City and the Gulf are set off by themselves and separately discussed. Such a general division of the territory of the United States conforms practically to the widest range thus far covered by any existing railroads or systems. Ambitious plans, notably that of the Gould system after 1901, and of the Farquhar syndicate, somewhat later, have sought in vain to constitute tenuous systems covering a wider territory than these historic areas. But their weakness from every point of view has been amply demonstrated. Any substantial system must have breadth as well as length, an amplitude of feeders as well as main stems; and there seems withal to be a pretty clearly defined upper limit of the aggregate mileage which may be efficiently operated. This limit of mileage will, of course, vary widely with the density of traffic and the details of operation. But, viewing the matter broadly, it seems not unlikely that any system ranging far and wide beyond the natural territorial divisions above described will either be lacking in breadth and stability of location, or will exceed the ability of a single management efficiently to handle. The experience of the federal Railroad Administration in dividing up the area of the country seems to confirm this view, that for operating and traffic purposes each system should be comprehended within the certain great territories above named.

The new statutory rule of rate making and the first decision rendered thereunder by the Interstate Commerce Commission—Ex Parte 74—also render it imperative in planning for comprehensive consolidation not to transgress the boundaries of these traditional territorial subdivisions. The purpose of the law being to fix reasonable rates, not for individual railroads but for entire groups, renders it essential that the grouping adopted for this purpose conform to that which is adopted in effecting the consolidations. Otherwise confusion in the administration of the new law would be bound to result.

Having adopted a subdivision of the country into certain great territorial districts for purposes of consolidation, how important is it that each system shall be rigidly confined within its own particular territory? In other words, are these boundaries to be strictly or loosely applied to the consolidations which are pro-

posed? The desirability is obvious of disturbing or disrupting existing corporations and relationships as little as possible; and yet consideration of the map indicates not infrequently that so-called trunk lines extend west of the Mississippi; that western railroads and southern companies penetrate one another's areas in order to reach strategic points; or that the southern lines have in the past found it desirable to extend northward across trunk line territory to Chicago. What shall be done with these odd bits and loose ends? Shall the Kansas City, Memphis & Birmingham, for example, be treated as an integral part of the southeastern systems, because it lies east of the Mississippi, although it is really a western railroad? Or shall the Illinois Central continue to reach the Missouri River at Omaha? The most difficult problem in this connection, fortunately confined to a single system, is to decide what to do with the Wabash. This property alone bridges two great and entirely distinct traffic areas, east and west of the Mississippi. Standing alone as a system in this regard, it may more fittingly be discussed elsewhere. But as to the loose ends of other systems which lie beyond their own appropriate territories, an attempt has been made to find for them, so far as may be, a natural alignment with the other properties within each of the great territorial subdivisions. It is believed that by such treatment a greater ease of administration of the law will be in the future provided. But precision must at all times be tempered by practicability; and, as in the limitation of rate areas or classification territory, an occasional lapse from system is deemed preferable to corporate or traffic dismemberment.

The preparation of a comprehensive consolidation plan necessarily upon occasion involves a disruption as well as a putting together of relationships for other purposes also than the one above mentioned. Obviously, such dismemberment should be rigidly minimized; and no proposal for so doing is made unless the evidence in its favor is most convincing. Were the plan in effect a final one involving large financial considerations, one might hesitate even under these circumstances. But having in mind that these proposals are purely tentative, that they are the preparation of a sketch or an ideal layout, the plan assumes the right to tear apart as well as to consolidate; in other words, to effect where necessary a comprehensive readjustment. The financial means to be adopted under these circumstances lie beyond the scope of this plan; but occasionally, as in chapter V

concerning the dissolution agreement between the Central Pacific and the Southern Pacific Company, a concrete illustration of the entire feasibility of unmerger, even in the face of an extreme financial and corporate entanglement, is afforded.

This tentative plan for consolidation proceeds upon the assumption that the distinction between so-called weak and strong roads, financially, is at present highly uncertain; and that it will require a period of experience under the new rates and under the new division of through rates as well as under the slowly readjusted commercial and industrial conditions after the war, in order to establish the relative earning power and credit of each. A period of trial is often necessary, both to reveal elements of strength and of weakness. Substantial equilibrium seems unlikely to be attained for a considerable period of time. Yet in the meanwhile, tentative plans must be set up, in preparation for the application of the final test of relative financial strength as soon as the available data make this possible. Not infrequently it will be found that in these plans it has been necessary to put together what appears to be a disproportionate number of weak roads, or at all events, of roads which have yet to establish their claim to entire stability. Particularly has this been the case in the so-called Gulf region, where practically all of the properties seem to be below par. No strong roads exist with which these may be consolidated, without extension of the scope of consolidation far beyond the bounds which are apparently laid down by traffic and operating experience. The same condition would obtain under the so-called New England plan for that particular territory, as well as for the peninsula of Michigan. The assumption is thus made that the purpose of this act being to rehabilitate the carriers through a new definition of reasonable rates, these entire groups of roads may be expected to prosper, to a degree as yet not ascertained, but none the less to a substantial amount. Whether this rehabilitation will ultimately warrant the grouping herein tentatively proposed, the future alone can decide. But necessarily the first step must be to provide for proper grouping in order to promote the best operating and traffic results. The responsibility for the subsequent financial success of the undertakings must then rest upon the exercise of the new rate-making powers, conferred upon the Interstate Commerce Commission by the act.

A peculiar difficulty in effecting consolidation of strong with weak roads and of reconciling such merger with existing operating

and traffic relationships, arises from the tendency of the weak roads to link up in series and to form thereby through routes extending sometimes clear across the country. For example, at Peoria a number of such roads meet: The Lake Erie & Western from the east, the Minneapolis & St. Louis from the north, and the Chicago, Peoria & St. Louis from the south. These various properties, together with the Wabash, the Chicago Great Western, the Clover Leaf, and the Nickel Plate, tend to exchange more freely with one another than with the standard or strong lines. From these strong lines, which have their own routes from end to end of each territory, they are naturally excluded, so that they are more or less compelled to associate with one another in the formation of what may be called substandard routes. Such routes were peculiarly the offenders in the old days of rate cutting. Their present-day bid for traffic is not infrequently based upon peculiar attention to dispatch or certainty of prompt delivery. This competition in service is naturally expensive and tends still further to attenuate their net earnings. Furthermore, these smaller subnormal properties oftentimes serve as the natural arms or extensions of the larger companies, which by reason of a paucity of feeders, are forced to rely upon such association. Thus the Erie, itself in precarious case financially, will be found more often to have united with these lesser substandard properties to form "existing routes and channels of trade." Under such conditions, the mandate of the statute, to preserve "as fully as possible and wherever practicable" such traffic associations, impels one of necessity toward consolidation of a number of equally substandard roads. Conformity with the other mandate of the statute by seeking to ally strong and weak properties to a like degree, thus threatens to overset the traffic relationships which have become customarily established by very force of circumstances. It is because of the clash between these at times discordant requirements, that the emergent result is so often a piebald compromise.

Several assumptions akin to the foregoing one are made in the following plan. The first is that for a number of roads a substantial readjustment of capitalization must occur as a prerequisite for consolidation. It is clear that this must be so by virtue of the authority vested in the Commission under section 5, paragraph 6b, already quoted. . . . The purpose, obviously, is to bring about the re-establishment of a due relationship between the

total volume of securities outstanding and the valuation assignable to the property for rate-making purposes, as well as the assurance of a sound relationship between indebtedness and capital stock. The experience of a number of recently reorganized properties is significant as indicating the recuperative effect of a drastic reorganization of capitalization. Roads once weak have become strong, not only capable of supporting themselves but of projecting their vigor into other properties with which they may be associated. Such notably seems to have been the case of late with the Pere Marquette and also the Pittsburgh & West Virginia. And it may well be that the Erie Railroad as well as others may upon such financial readjustment disclose an actual earning power which has in the past been concealed through a distorted relationship between capitalization and investment.

It is likewise presupposed throughout this report that all of the new powers conferred upon the Interstate Commerce Commission by the transportation act, 1920, will be upheld constitutionally. An entire transformation in the relation between this administrative branch of the government and the judicial arm has been brought about. Sporadic control by the courts, as evidenced in the pending dissolution proceedings concerning the Central Pacific and Southern Pacific companies and the Philadelphia & Reading and Central of New Jersey, it is assumed now yield place to a continuing supervision and control by the Interstate Commerce Commission, acting as a branch of the executive authority. Such a complete reversal of public policy must lead to protracted litigation; but regardless of the final outcome no course in connection with this report is possible save to hold that the will of Congress as expressed in the transportation act is governing and supreme. Not even judicial decisions under the Sherman act or the commodity clause of the act to regulate commerce are held to constitute a bar to the free allocation of these properties to the new systems provided by this plan. All of the roads concerned in such proceedings are therefore treated with entire freedom, assuming that the final decision as to the propriety of such placement will rest in future not with the courts but with the Interstate Commerce Commission.

Another far-reaching assumption is vital to the success of this plan. This has to do with the operation of terminals at great centers. Historically, there has been the greatest diversity of experience in this regard between the carriers of the country.

Some roads are peculiarly fortified as to terminals, while possessing weak lines from an operating standpoint across the open country. For others, the reverse is true. Some companies, entering the field late, enjoy good locations as to line, but have always worked under a handicap at the terminals. Such lines are strong in the open but weak at the ends. Others—the Atlanta, Birmingham & Atlantic, for example—were really constructed across country rather to utilize an existent terminal than because of a demonstrated need for the new cross-country line. But whatever the cause for the existing situation, a practically universal demand of shippers is that they be able freely to exercise their routing rights by the provision of open terminals, both at the point of shipment and at destination. The right of route across country is impaired if the only possible delivery is at an inconvenient point. To put together railway lines on the map without having a constant regard to the possibility of free delivery or receipt at either end would indeed be futile. As to the particular means for accomplishment of this object—free and untrammeled utilization of terminals—there may well be difference of opinion. Conceivably, joint ownership and operation, as at St. Louis, may succeed in that environment, while reciprocal switching may satisfactorily answer the purpose as at Chicago. But, whatever the means adopted to this end, it is submitted that a proper adjustment of the various terminal situations, always of course for due compensation, is an important adjunct to any comprehensive consolidation plan. No recommendation, therefore, as to particular terminal remedies is offered in this report. The subject technically is so involved, that it might well be made matter for a special investigation. Its bearing upon and relation to the subject of the division of through rates is as obvious as is its intimate connection with consolidation. The pending New York Central application to acquire the Chicago Junction Railway raises in itself almost all the possible aspects of terminal problems. Consolidation can never be effectively brought about without the adoption of a comprehensive policy as to terminal ownership, operation, or both. It is herein assumed that free access will be somehow provided, either under the present emergency powers as contained in section 1, paragraph 15c, or by the adoption under a consolidation plan of permanent arrangements in all of the important centers. Possibly the assignment of terminal properties might take place by means of leases based upon valuation by the Commission and at

a rate fixed by the Commission as reasonable. This would permit the terminal companies to remain under the joint control of the several participating railroads, rather than that entirely independent terminal companies, actually owning these facilities, should be set up. The important point, whatever the means adopted to this end, is that there should be unified operation and entirely free access to all participants alike.

Another general principle constantly kept in mind in connection with consolidation and having substantial effect upon it is the encouragement of alternate routes and gateways, in order to relieve present or prospective congestion at the great railway meeting points. A tendency has been strikingly manifest for many years for all the great systems to expend funds unstintingly upon their main stems, and all of these main stems tend to run together at certain nodal points, notably New York, St. Louis, and Chicago. Such concentration upon great cities is a natural response to the commercial forces which tend with increasing power to attract traffic, even although it may not be destined for that place but may be passing through en route to points beyond. The shippers' routing often dictates such shipments in order to take advantage of a change in market conditions. The result has been an undue congestion in times of emergency, which paralyzes the commerce of the country. There is always a certain proportion of business, however, which by careful attention to the matter might be consolidated and shipped by an alternate route which should avoid the great center. Thus the Michigan ferry routes or certain of the gateways south of Chicago have in the past afforded relief. But the latter especially, it is submitted, have not in the past received the attention which they deserve, and an attempt has been made wherever possible to cultivate such direct relationships between the different systems proposed by the establishment of definite and common gateways of this sort.

The preparation of such a plan of consolidation thus affords a unique opportunity for the evolution of a comprehensive plan for the development of national resources. Too often in the past purely temporary or personal considerations of advantage or profit have determined the location of our American railways. The administrative control of the terms on which the carrier companies may be allowed further to ally themselves in the future may, if wisely administered, contribute to diminish economic waste and to promote commercial development. But such wise

administration demands a comprehensive plan adopted in advance, and it is evidently the purpose of the act to draw up this plan, not alone for the attainment of the immediate rate-making end but also with a view to the larger purpose of a right direction of our economic resources as a nation in the years to come.

2. Railroad Consolidation [1]

The Esch-Cummins Act of 1920 embodies a new legislative policy with regard to railroad combinations. Prior to the passage of this act restraints upon railroad competition had been frowned upon as likely to lead to the exaction of extortionate charges. Thus, the original Act to Regulate Commerce of 1887 forbade the pooling of freight or earnings. Three years later the Sherman Anti-Trust Act forbade every contract or combination in restraint of interstate or foreign commerce, and every monopoly or attempt to monopolize. Notwithstanding the prohibitions of the Sherman Act, numerous far-reaching railroad combinations were organized, but they met with judicial displeasure in certain outstanding cases, and many of them were subsequently dissolved. The legislative policy was thus opposed to combinations of competing railroads, whether effected through lease, stock ownership, or consolidation (merger).

The Esch-Cummins Act introduces a new policy. This act (and earlier legislation) placed railroad charges so completely under the control of the Interstate Commerce Commission that there was no longer any particular occasion for alarm over the effect of railroad pools and combinations upon rates and fares. Accordingly the Esch-Cummins Act authorizes the Commission to sanction pools if in its opinion they will improve service, promote economy of operation, and not restrain competition unduly. It also empowers the Commission to permit one railroad to acquire control over another either under a lease or by the purchase of stock or in any other manner not involving their consolidation into a single system, if in the opinion of the Commission such acquisition is in the public interest. And, finally, it provides in some detail for the consolidation of railroads into single systems in accordance with a plan to be adopted by the Commission. It is with consolidations that this article deals.

[1] From Eliot Jones, *North American Review*, vol. 221, pp. 440–453 (March, 1925). Reproduced by permission of the publisher. See Vanderblue and Burgess, pp. 432–434.

The Esch-Cummins Act directs the Commission to prepare, as soon as practicable, a plan for the consolidation of the railway properties of the United States into a limited number of systems. Under the plan competition is to be preserved as fully as possible, and wherever practicable the existing routes and channels of trade are to be maintained. The plan prepared by the Commission is to be regarded as tentative, and ample opportunity is to be afforded to everyone to present objections thereto. Subsequently the Commission is to adopt a complete plan, and no consolidations are to be authorized that are not in harmony therewith.

Railroads desiring to consolidate are to make application to the Commission for the necessary permission. If, after a hearing, the Commission finds that the public interest will be promoted by the consolidation, and enters an order authorizing it, the consolidation may thereupon be effected, "the law of any State or the decision or order of any State authority to the contrary notwithstanding". Any corporation organized to effect a consolidation approved by the Commission is thereby relieved from the operation of the anti-trust laws and of all other prohibitions, State or Federal, in so far as may be necessary to enable it to do anything authorized by the order of the Commission. However, no consolidated corporation may have a capitalization exceeding the value of the consolidated properties as determined by the Commission.

What is the purpose of these consolidation provisions, which constitute such a sharp break with the past? The primary purpose, without a doubt, is to promote the successful operation of the rule of rate making. This rule, incorporated in the Esch-Cummins Act, provides that the Interstate Commerce Commission shall initiate and establish rates so that the railroads as a whole (or as a whole in such rate groups as the Commission may designate) will, under honest and economical management and reasonable expenditures for maintenance, earn, as nearly as may be, a fair return on the aggregate value of their property. The satisfactory administration of this rule could hardly be anticipated, however, if there continued to be numerous railroads of widely varying strength. This is because a level of rates that is adequate for the stronger roads will be quite inadequate for the weaker ones; and a level of rates that is adequate for the weaker ones will enable the stronger ones to make extortionate profits. Accordingly, Congress authorized the consolidation of the rail-

roads in accordance with the plan of the Commission. The intention of Congress was that the weak roads should be consolidated with the strong in such manner that there would be created in each rate group a limited number of large systems of approximately equal strength, and able under uniform rates upon competitive traffic to earn substantially the same rate of return upon the value of their properties. Thereby the task of rate regulation in accordance with the rule of rate making would be facilitated. Moreover, there would be attained a more evenly balanced competition among the railroads, and consequently a higher grade of transportation service. The Esch-Cummins Act contains other provisions designed to promote the operation of the rule of rate making—for example, the recapture clause and the division of joint rates among the parties thereto—but they are less important than the consolidation provisions.

The consolidation programme as a device for meeting the problem presented by the weak roads has been criticized in several respects. It has been urged that our objective should not be the elimination of the weak roads, but the elimination of *weakness*. Some roads are weak because of inefficient management, and while consolidation might lead to better management, such a drastic remedy is not required to remove the cause of weakness. Some roads are weak because of an ill-balanced financial structure, an excessively large proportion of the earnings being absorbed by the fixed charges, such as interest on bonds; but the remedy here is a readjustment of the capital structure, and not consolidation. Some roads are weak because their main source of traffic (mineral products, for example) has become exhausted; but the best policy in such cases is the abandonment of the road, and not its consolidation with another system, upon which the weak line might be expected to feed, like a parasite.

The desirability of eliminating weakness is conceded, and also the possibility of eliminating some weakness without resort to consolidation. None the less the consolidation programme can still be justified as a device for evening up earning power, and thus promoting the operation of the rule of rate making. There are other causes of weakness than poor management, unwieldy capital structure, and exhaustion of traffic. Some roads are weak because they lack access to the points of traffic origination or interchange, or because they run at right angles to the normal currents of trade, or because they serve regions of relatively sparse traffic, or because

they encounter active water competition. Such roads are likely to remain weak, yet they may be indispensable to the communities that they serve. These roads can best be placed in a position to perform satisfactorily their common carrier obligations by being linked up with a stronger system. The consolidation may or may not eliminate the weakness, but it will eliminate the weak road by uniting it with a system able to maintain the proper service standards.

The consolidation programme is further criticized on the ground that even though we succeed in building up large systems of comparatively equal strength it will be only a matter of time before the systems are again of quite unequal strength. The New Haven was once a very strong road, and may become so again, but it certainly can not be regarded as such at this time. The Pennsylvania and the Chicago and Northwestern are not nearly so strong today as they once were. On the other hand, the Southern Railway has greatly improved its condition, and may soon be regarded as a strong road. So long as population and trade continue to expand, and expand unevenly, so long may we expect shifts in the strength of roads and the emergence here and there of weakness. This is particularly true in view of the fact that the process of consolidation involves at the outset the saddling of the weak roads upon the strong. There are numerous examples in railroad history of prosperous roads that have failed because of an unduly far-reaching combination or an overload of unprofitable extensions or branches. And may not the same prove to be the outcome if the Government, through the exercise of persuasion or pressure, brings about the consolidation of roads against the best judgment of their managers? There is always the danger, of course, that some of the systems thus created may prove to be too large for the most effective operation, unless the management is unusually capable; and here again an inequality of strength may subsequently appear. The requirements of the rule of rate making apparently make it necessary for us to run these risks, but in assuming them we should not close our eyes to the possible dangers.

Though the primary purpose of consolidation is to build up systems of more uniform strength, and thus promote the administration of the rule of rate making, there are those who believe that through consolidation numerous economies could be realized, and thereby the level of rates reduced or the quality of service improved. That certain economies could be achieved, there can be

no doubt. It is agreed on all sides that consolidation would permit a saving through the reduction of intercompany accounting. For example, under present arrangements a person making a trip from New York City to San Francisco via the New York Central, Chicago and Northwestern, Union Pacific, and Central Pacific would normally buy a through ticket from the New York Central; and this road would settle with the other three roads for their portion of the haul. Essentially the same arrangement is followed as to freight; one railroad (the originating road or the delivering road) collects the entire charge, and apportions it among the roads that participated in the haul. Under consolidation, however, there would be less of this intercompany accounting, and the more far-reaching the consolidation, the greater the saving.

Consolidation would also effect a saving through the reduction of car interchange. Whereas locomotives seldom leave the home tracks, freight cars travel freely over the entire country; indeed they may be off the line of the owning road for months at a time. Though this same arrangement would be followed under consolidation, the reduction in the number of systems would bring it about that a larger proportion of a railroad's cars remained "at home." The diminution in the amount of car interchange would cut down the volume of intercompany accounting and facilitate the making of repairs. As regards the former, if one railroad holds or uses the cars of another it must make payment therefor, the present charge being one dollar a day. In view of the fact that there are more than 2,400,000 freight cars, a considerable proportion of which are off the line of the owning road, it is clear that much labor is involved in keeping the necessary accounts. Consolidation would not eliminate this expense, but it would greatly diminish it. As regards repairs, if a "foreign" car is in need of repair, the tendency is for the using road to patch it up, and to let the owning road make the major repairs that are necessary. The postponement of the necessary repairs, however, may shorten the life of the car. Therefore, the larger the proportion of a railroad's cars that is at home, the greater the likelihood of prompt and effective repair, and the lower the cost of car maintenance and replacement.

Consolidation would admit of still further economies, as, for example, the more direct routing of freight, the joint use of facilities, and the standardization of materials and equipment. Additional savings suggested by advocates of consolidation are: the

purchase of materials and supplies in larger quantities; the repair of locomotives and cars in fewer and larger shops; the reduction of traffic solicitation (with the abolition of certain off-line agencies); the greater use of solid trainloads; the elimination of some switching; the discontinuance of duplicate train service; the diminution in the number of tariffs; the consolidation of car inspection forces; and the reduction in the number of general officers.

Upon a superficial examination this list may seem imposing, and to some convincing. Upon closer examination, however, legitimate doubt arises as to the importance of these economies. The largest single item of railway expense is the wage bill, which accounts for approximately half of the total expenditures. This item would hardly be greatly affected by consolidation. Second in amount is the cost of materials and supplies, and this would be lowered but a fraction, if at all. Taxes would certainly be no less. Rentals of leased lines would be less, but this would be merely a matter of accounting, as the owners of the leased line, if it became a part of a consolidated system, would have to be recompensed adequately, as before. Interest payments on outstanding indebtedness would be the same, though if the effect of the rule of rate making (combined with consolidation) were to improve railroad credit, new funds could be secured from time to time on more favorable terms, and the amount of revenue required by the railroads to perform satisfactorily their transportation service and to remunerate adequately their security owners would be reduced. While, therefore, there might be some saving in interest, the amount at first would be slight. And once we have deducted from the aggregate railroad expenditures the items of wages, materials and supplies, taxes, rentals, and interest, there is very little left. And if there is little left, there is obviously no opportunity for large savings through a limited programme of consolidation. This is the view of such an experienced railroad official as Judge R. S. Lovett, the head of the Union Pacific. In testimony before a Congressional Committee he expressed the conviction that except for city terminals, which should be taken in hand by the Government in any event, the savings that could be effected through consolidation were relatively slight. This is also the view of *The Railway Age,* which favors consolidation, but which maintains that there is "little or no evidence that large economies would result from consolidating all the railways into a few large systems."

Moreover, the consolidation of all the railways into a limited

number of systems would present to the management problems of organization and administration of the first magnitude. Thus, to consolidate the railroads into nineteen companies, as was proposed by the Interstate Commerce Commission, would create systems averaging over 13,000 miles of line, and receiving earnings of approximately $300,000,000 per annum. To operate properties of this size with effectiveness would require administrators of a very high order; and it would remain to be seen whether they could (and would) be secured. If not, such economies as were actually realized might easily be more than offset by the wastes of an unwieldly administration. Upon this point the views of Sir Henry W. Thornton, president of the Canadian National Railways, are of interest. Speaking at Chicago in October, 1924, he said: "Personally I question, from an administrative point of view, the wisdom of enlarging any of the great railway systems of the United States, such as the New York Central and the Pennsylvania, because I doubt the ability of any railway president efficiently and effectively to administer any larger mileage than that of the railways I have mentioned, having in mind their density of traffic." As Sir Henry has had a varied experience in this country, England, and Canada, in railroad positions of high responsibility, his views upon this matter are clearly entitled to great respect.

So much for the purposes of consolidation. Let us now consider what progress the Commission has made with its plan, and what the prospects are of its acceptance. The tentative plan of the Commission was agreed upon in August, 1921. It provided for nineteen systems, as follows: five trunk lines from New York City to Chicago (and St. Louis); one regional system for New England, or, as an alternative, the consolidation of particular New England railroads with certain of the trunk lines; one line in the Michigan peninsula; two bituminous coal lines from the Great Lakes to Chesapeake Bay; three Southeastern lines; two Southwestern lines; and five transcontinental lines from Chicago to the Pacific Coast. As the law requires, the Commission preserved, whenever possible, the competition of rival routes, not at all with the idea of maintaining competition in rates, but with the idea of promoting competition in service. Notwithstanding the fact that it is government regulation, and not competition, that is now relied upon to ensure reasonable rates, reliance is still placed upon competition to secure satisfactory and efficient service.

This explains why the consolidations are not by regions, as in England, but by systems more or less parallel to one another. The deadening effect of regional monopolies under private ownership is thus avoided.

Hearings upon the tentative plan of the Commission were begun in April, 1922, and continued for more than a year and a half, being concluded in December, 1923. The last day for the filing of briefs by interested parties was set at February 9, 1924. Since that date the Commission has been engaged in the preparation of a definite plan—one that will meet the valid objections raised to the tentative plan. To be sure, a number of railroad combinations have been authorized by the Commission during the past year. The Commission approved, during June to December, 1924, the acquisition by the Louisville and Nashville and the Atlantic Coast Line of joint control of the Carolina, Clinchfield and Ohio through lease; the purchase by the Missouri Pacific from the Western Pacific of one-half of the stock of the Denver and Rio Grande Western, the other half being retained by the Western Pacific; the purchase by the New Orleans, Texas and Mexico of the capital stock of the International-Great Northern; the acquisition by the Missouri Pacific of a majority of the capital stock of the New Orleans, Texas and Mexico; and the control by the Southern Pacific of the El Paso and Southwestern through stockownership and lease. Though these combinations were, for the most part, in harmony with the Commission's tentative plan, not one of them was in fact a consolidation, as that term is used in the Esch-Cummins Act.

The most far-reaching proposal, however, is that of the New York, Chicago and St. Louis, popularly known as the Nickel Plate. This road long formed a part of the New York Central system, but in 1916 it was acquired by the Van Sweringen brothers of Cleveland. At that time the Nickel Plate extended only from Buffalo to Chicago. In 1922 the Nickel Plate acquired control of the Lake Erie and Western, and of the Toledo, St. Louis and Western. This gave it a line from Buffalo through Cleveland to three mid-western gateways—Chicago, Peoria, and St. Louis—with lines extending also to Detroit, Toledo, Sandusky, and Indianapolis. This combination, which was a relatively minor one, was in accordance with the Commission's tentative plan. But the Van Sweringen brothers, with their powerful financial backers, now propose a much more ambitious project, and one

that is not harmony with the tentative plan. They propose that a new Nickel Plate company shall be formed to combine, through stockownership and lease, the old Nickel Plate, the Chesapeake and Ohio, the Hocking Valley, the Erie, and the Père Marquette. This plan has been approved by the boards of directors of the five companies, and presumably, by this time, by the stockholders also. This arrangement is commonly spoken of as a consolidation, and it is true that the proposed leases provide for the consolidation of the properties of the several companies into one corporation, when authorization therefor has been secured from the Interstate Commerce Commission. Inasmuch, however, as the Commission has not yet given its approval, it is incorrect to refer to this arrangement as for all practical purposes an accomplished fact, as so many newspaper writers have done. Progress in railway consolidation has thus been less than is popularly supposed.

Whether or not the Nickel Plate consolidation be eventually brought about, there is considerable doubt, in our opinion, whether all the railroads of the country will be consolidated into a limited number of systems in the near future, or indeed at all. There are several reasons for anticipating delay. In the first place, the Commission must adopt a complete plan for the entire country. This task having been finished, the railroads will then proceed to conduct negotiations with regard to the terms of consolidation, assuming, that is, that they decide to go ahead. But at once they encounter an obstacle. The Esch-Cummins Act provides that the capitalization of a consolidated company shall not exceed the value of the consolidated properties as determined by the Commission. To date, however, the final value of only a few properties has been ascertained, and it will be a matter of years presumably before this highly controversial matter is settled. Since the railroads will hardly care to enter a consolidation that has a capitalization below the value of the combined properties, they will probably wait until the value of their properties has been determined before deciding whether to consolidate. As the Commission is directed, upon the filing of an application for authority to consolidate, to proceed immediately to ascertain the value of the properties involved therein, individual consolidations will perhaps be effected from time to time, but the completion of the consolidation programme will unquestionably be delayed until the task of valuing the railway property of the country has been finished. Once this has been accomplished, the negotiations be-

tween the representatives of the roads that are to consolidate will consume many months, and thus there will be further delay.

Not only is delay to be anticipated, but even an actual refusal to consolidate in accordance with the Commission's plan. That this is a contingency was established by the hearings held upon the tentative plan. By this plan the Chicago, Burlington and Quincy, which is now jointly owned by the Northern Pacific and the Great Northern, was to be merged with the Northern Pacific; while the Chicago, Milwaukee and St. Paul was to be merged with the Great Northern. The Chicago, Burlington and Quincy is a very prosperous road, whereas the Chicago, Milwaukee and St. Paul is not. The officials of the Northern Pacific and the Great Northern argued that the Chicago, Burlington and Quincy, the Northern Pacific, and the Great Northern should be consolidated; and promised that if the Commission would sanction this arrangement, the steps necessary to make it effective would straightway be taken. If, however, the Northern Pacific and the Great Northern might not be merged, both roads wanted the Chicago, Burlington and Quincy, and neither would have the Chicago, Milwaukee and St. Paul. President Donnelly, of the Northern Pacific, and President Budd, of the Great Northern, made it quite clear to the Commission that they would refuse to go into any consolidation that involved parting with the Chicago, Burlington and Quincy.

By the tentative plan the Illinois Central and the Seaboard Air Line were to be consolidated. President Markham of the Illinois Central testified that his road did not want the Seaboard Air Line, and that he could not conceive of any possible conditions under which the two roads might profitably be put together. With regard to the Tennessee Central, which was assigned to the Illinois Central, President Markham said that his road had once given some consideration to the purchase of the Tennessee Central, and had decided that it would not take it as a gift. President Rea of the Pennsylvania objected to the plan because it deprived his road of the Norfolk and Western, with which it had long been intimately allied. The representative of the Detroit, Toledo and Ironton (Henry Ford's railroad) expressed opposition to consolidation with the Père Marquette. He pointed out the Detroit, Toledo and Ironton was endeavoring to solve some railroad problems along new lines, and that if this road were consolidated with the Père Marquette, these experiments would undoubtedly be abandoned. And a very acute controversy raged over the pro-

posal of the Commission to assign the Philadelphia and Reading and the Central of New Jersey to the Baltimore and Ohio, the opposition being led by the New York Central.

It is clear from the foregoing illustrations that the consolidation programme may encounter effective opposition. The inducement to consolidate may prove inadequate, and resistance in certain cases be determined upon. The strong roads may decide not to take the weak, despite the clearly expressed intent of the Transportation Act of 1920. The recapture clause, to be sure, does provide an incentive when a road is particularly strong. Just why this is the case, is not always clearly seen, and therefore it may be advisable to give an illustration that will show concretely why a strong road might find it to its interest to consolidate with a weak one. Suppose railroad A has a capitalization of $100,000,000, property valued at $100,000,000, and a net operating income of $10,000,000. As, under the recapture clause, one-half of all income in excess of six per cent. upon the value of the property is recaptured by the Government, the road may retain only $8,000,000 of the $10,000,000 earned by it. Suppose now railroad A consolidates with railroad B, which also has a capitalization of $100,000,000, and property valued at $100,000,000, but a net income of only $2,000,000; and suppose, further, that by the terms of the consolidation three-fourths of the securities of the consolidated company (C) go to the former bondholders and stockholders of railroad A, and one-fourth to those of railroad B. By this arrangement nothing accrues to the Government under the recapture clause; for the consolidated company earns only six per cent. on the value of its property ($12,000,000 on $200,000,000). The former bondholders and stockholders of railroad A receive three-fourths of the income of railroad C, or $9,000,000. As this is $1,000,000 more than they were allowed to retain prior to the consolidation, they are better off (or at any rate the stockholders are, and the bondholders will be if the bonds of railroad C bear a somewhat higher rate of interest than those of railroad A). The former bondholders and stockholders of railroad B receive one-fourth of the income of railroad C, or $3,000,000. As this is $1,000,000 more than they earned prior to the consolidation they also are better off. As both parties gain, there is an inducement to consolidate.

Notwithstanding the fact that there is sometimes an inducement to consolidate to prevent the recapture of excess earnings,

the inducement will not always be adequate. In the foregoing illustration we assumed that the weak road, of inferior earning capacity, had a high property value; in fact as high a property value as that of the strong road of large earning power. When this is the case the strong road, unwilling to share one-half of its excess earnings with the Government, may consent to take over the weak road, since thereby it reduces the ratio of its earnings to the valuation. But if the low earnings of the weak road go hand in hand with a low valuation of its property (say $50,000,000 instead of $100,000,000 as in the illustration), the recapture clause may lose its force. Moreover, difficulty is likely to be experienced in agreeing upon terms acceptable both to the strong roads and the weak. The mere fact that there are spoils to divide will not ensure consolidation, for the parties may not be able to agree upon the division thereof. The matter is complicated, of course, by the fact that the several railroads to be consolidated will have outstanding various kinds of securities, and it will be hard to reach an agreement upon the order of priority of these numerous claims. Then there is the natural desire of the officials and certain stockholders to maintain the independence of their properties; the opposition of certain communities to the merging of a local road with a larger system having a lesser interest in that particular locality; and the necessity in some cases of cutting down the volume of securities.

To promote the consolidation programme it has been suggested, notably by Secretary Hoover, that the Government take active steps to expedite it. Secretary Hoover recommends that two years be allowed for voluntary consolidations in accordance with the plan finally adopted by the Commission; and that at the end of that time the Commission appoint an organization committee for each group not consolidated. These committees are to determine the value of the outstanding securities of the component roads, valuing each class or issue separately, provided that the total value fixed for the securities of any road does not exceed the value of that road as determined by the Interstate Commerce Commission. Each committee is to have the right to create a federal corporation which will offer to exchange its securities for those of the component roads upon the basis of the values fixed by the committee. If a majority of the stockholders of a component road make the exchange, the committee shall have the right at law to acquire the non-consenting minority stock at its

fair value; if a majority fail to make the exchange, the committee shall have the right, if the approving roads agree to finance the transaction, to acquire the dissenting roads under powers of eminent domain. It is well to note the inclusion of the proviso that the committee shall proceed with condemnation only if the approving roads agree to take the condemned roads off the committee's hands. Under our present laws the Government can force a railroad to dispose of its property, but it can not compel another railroad or group of railroads to buy it. If, therefore, the approving roads are unwilling to acquire the condemned road at the cost of condemnation the matter rests there, and the consolidation programme goes uncompleted.

A bill embodying substantially the recommendations of Secretary Hoover was introduced by Senator Cummins, but despite the fact that it had the approval of President Coolidge it failed of passage.

In conclusion, it may be noted that our ideas with regard to consolidation seem to be changing very rapidly. In 1912 the Union Pacific-Southern Pacific combination was dissolved, and as recently as 1922 the Supreme Court found the Southern Pacific-Central Pacific combination to be violative of the Sherman Anti-Trust Act. Now, however, the railroads are being warned that if they do not consolidate with reasonable promptness we may invoke compulsion. This is truly a remarkable reversal of governmental policy; and we may well wonder whether five or ten years hence this policy will command the support of public opinion.

PART VI

RAILROAD LABOR

CHAPTER XXV

WAGES[1]

1. THE POWER OF THE NATIONAL GOVERNMENT: WILSON v. NEW[2]

MR. CHIEF JUSTICE WHITE delivered the opinion of the court.

Was there power in Congress under the circumstances existing to deal with the hours of work and wages of railroad employees engaged in interstate commerce, is the principal question here to be considered. Its solution as well as that of other questions which also arise will be clarified by a brief statement of the conditions out of which the controversy arose.

Two systems controlled in March, 1916, concerning wages of railroad employees; one, an eight-hour standard of work and wages with additional pay for overtime, governing on about fifteen per cent of the railroads; the other, a stated mileage task of 100 miles to be performed during ten hours, with extra pay for any excess, in force on about eighty-five per cent of the roads. The organizations representing the employees of the railroads in that month made a formal demand on the employers that as to all engaged in the movement of trains except passenger trains the 100-mile task be fixed for eight hours, provided that it was not so done as to lower wages and provided that an extra allowance for overtime calculated by the minute at one and one-half times the rate of the regular hours service, be established. The demand made this standard obligatory on the railroads but optional on the employees, as it left the right to the employees to retain their existing system on any particular road if they elected to do so. The terms of the demand were as follows. . . .

"Article 1 (a) In all road service 100 miles or less, eight hours or less will constitute a day, except in passenger service. Miles in excess of 100 will be paid for at the same rate per mile.

"(b) On runs of 100 miles or less overtime will begin at the expiration of eight hours.

[1] On the subject of labor and labor disputes see Jones, pp. 411–431, 460–464, 470–475, 560–562, 565–566, 571–578, 580–588, and Vanderblue and Burgess, pp. 372–397.

[2] 243 U. S. 332 (March 19, 1917). See Jones, pp. 428–431, and Vanderblue and Burgess, pp. 221–222.

"(c) On runs of over 100 miles overtime will begin when the time on duty exceeds the miles run divided by 12½ miles per hour.

"(d) All overtime to be computed on the minute basis and paid for at time and one-half times the pro rata rate.

"(e) No one shall receive less for eight hours or 100 miles than they now receive for a minimum day or 100 miles for the class of engine used or for service performed.

"(f) Time will be computed continuously from time required for duty until release from duty and responsibility at end of day or run."

The employers refused the demand and the employees through their organizations by concert of action took the steps to call a general strike of all railroad employees throughout the whole country.

The President of the United States invited a conference between the parties. He proposed arbitration. The employers agreed to it and the employees rejected it. The President then suggested the eight-hour standard of work and wages. The employers rejected this and the employees accepted it. Before the disagreement was resolved the representatives of the employees abruptly called a general strike throughout the whole country fixed for an early day. The President, stating his efforts to relieve the situation and pointing out that no resources at law were at his disposal for compulsory arbitration, to save the commercial disaster, the property injury and the personal suffering of all, not to say starvation, which would be brought to many among the vast body of the people if the strike was not prevented, asked Congress, first, that the eight-hour standard of work and wages be fixed by law, and second, that an official body be created to observe during a reasonable time the operation of the legislation and that an explicit assurance be given that if the result of such observation established such an increased cost to the employers as justified an increased rate, the power would be given to the Interstate Commerce Commission to authorize it. Congress responded by enacting the statute whose validity as we have said we are called upon to consider. Act of September 3, 5, 1916, 39 Stat. 721, c. 436. The duty to do so arises from the fact that the employers, unwilling to accept the act and challenging the constitutional power of Congress to enact it, began this typical suit against the officers of certain labor unions and the United States District Attorney to enjoin the enforcement of the statute. The law was made to take effect only on

the 1st of January, 1917. To expedite the final decision before that date, the representatives of the labor unions were dropped out, agreements essential to hasten were made and it was stipulated that pending the final disposition of the cause the carriers would keep accounts of the wages which would have been earned if the statute was enforced so as to enable their payment if the law was finally upheld. Stating its desire to coöperate with the parties in their purpose to expedite the cause, the court below, briefly announcing that it was of opinion that Congress had no constitutional power to enact the statute, enjoined its enforcement and, as the result of the direct appeal which followed we come, after elaborate oral and printed arguments, to dispose of the controversy.

All the propositions relied upon and arguments advanced ultimately come to two questions: First, the entire want of constitutional power to deal with the subjects embraced by the statute, and second, such abuse of the power if possessed as rendered its exercise unconstitutional. We will consider these subjects under distinct propositions separately.

I. *The entire want of constitutional power to deal with the subjects embraced by the statute.*

To dispose of the contentions under this heading calls at once for a consideration of the statute and we reproduce its title and text so far as is material.

An Act To establish an eight-hour day for employees of carriers engaged in interstate and foreign commerce, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That beginning January first, nineteen hundred and seventeen, eight hours shall, in contracts for labor and service, be deemed a day's work and the measure or standard of a day's work for the purpose of reckoning the compensation for services of all employees who are now or may hereafter be employed by any common carrier by railroad, except railroads independently owned and operated not exceeding one hundred miles in length, electric street railroads, and electric interurban railroads, which is subject to the provisions of the Act of February fourth, eighteen hundred and eighty-seven, entitled "An Act to regulate commerce," as amended, and who are now or may hereafter be actually engaged in any capacity in the operation of trains used for the transportation of persons or property on railroads, except railroads independently owned and operated

not exceeding one hundred miles in length, electric street railroads, and electric interurban railroads, . . .

Sec. 2. That the President shall appoint a commission of three, which shall observe the operation and effects of the institution of the eight-hour standard workday as above defined and the facts and conditions affecting the relations between such common carriers and employees during a period of not less than six months nor more than nine months, in the discretion of the commission, and within thirty days thereafter such commission shall report its findings to the President and Congress; . . .

Sec. 3. That pending the report of the commission herein provided for and for a period of thirty days thereafter the compensation of railway employees subject to this Act for a standard eight-hour workday shall not be reduced below the present standard day's wage, and for all necessary time in excess of eight hours such employees shall be paid at a rate not less than the pro rata rate for such standard eight-hour workday.

Sec. 4. That any person violating any provision of this Act shall be guilty of a misdemeanor and upon conviction shall be fined not less than $100 and not more than $1,000, or imprisoned not to exceed one year, or both.

There must be knowledge of the power exerted before determining whether as exercised it was constitutional and we must hence settle a dispute on that question before going further. Only an eight-hour standard for work and wages was provided, is the contention on the one side, and in substance only a scale of wages was provided, is the argument on the other. We are of the opinion that both are right and in a sense both wrong in so far as it is assumed that the one excludes the other. The provision of section one that "eight hours shall . . . be deemed a day's work and the measure or standard of a day's work" leaves no doubt about the first proposition. As to the second, this is equally true because of the provision of section three forbidding any lowering of wages as a result of applying the eight-hour standard established by section one during the limited period prescribed in section two. Both provisions are equally mandatory. If it be said that the second, the depriving of all power to change the wages during the fixed period, is but ancillary to the first command, the standard of eight hours that would not make the prohibition as to any change of wages any the less a fixing of wages. It certainly would not change the question of power unless it could be assumed that the legislative

power to fix one thing, the standard of hours, could be enforced by exerting the power to do another, fix the wages, although there was no legislative authority to exert the latter power. The doing of one thing which is authorized cannot be made the source of an authority to do another thing which there is no power to do. If to deprive employer and employee of the right to contract for wages and to provide that a particular rate of wages shall be paid for a specified time is not a fixing of wages, it is difficult to see what would be.

However, there is this very broad difference between the two powers exerted. The first, the eight-hour standard, is permanently fixed. The second, the fixing of the wage standard resulting from the prohibition against paying lower wages, is expressly limited to the time specified in section two. It is, therefore, not permanent but temporary, leaving the employers and employees free as to the subject of wages to govern their relations by their own agreements after the specified time. Concretely stated, therefore, the question is this: Did Congress have power under the circumstances stated, that is, in dealing with the dispute between the employers and employees as to wages, to provide a permanent eight-hour standard and to create by legislative action a standard of wages to be operative upon the employers and employees for such reasonable time as it deemed necessary to afford an opportunity for the meeting of the minds of employers and employees on the subject of wages? Or, in other words, did it have the power in order to prevent the interruption of interstate commerce to exert its will to supply the absence of a wage scale resulting from the disagreement as to wages between the employers and employees and to make its will on that subject controlling for the limited period provided for?

Coming to the general considerations by which both subjects must be controlled, to simplify the analysis for the purpose of considering the question of inherent power, we put the question as to the eight-hour standard entirely out of view on the ground that the authority to permanently establish it is so clearly sustained as to render the subject not disputable.

That common carriers by rail in interstate commerce are within the legislative power of Congress to regulate commerce is not subject to dispute. It is equally certain that where a particular subject is within such authority the extent of regulation depends on the nature and character of the subject and what is appropriate

to its regulation. The powers possessed by government to deal with a subject are neither inordinately enlarged nor greatly dwarfed because the power to regulate interstate commerce applies. This is illustrated by the difference between the much greater power of regulation which may be exerted as to liquor and that which may be exercised as to flour, dry-goods and other commodities. It is shown by the settled doctrine sustaining the right by regulation absolutely to prohibit lottery tickets and by the obvious consideration that such right to prohibit could not be applied to pig iron, steel rails, or most of the vast body of commodities.

What was the extent of the power therefore of Congress to regulate considering the scope of regulation which government had the right to exert with reference to interstate commerce carriers, when it came to exercise its legislative authority to regulate commerce? is the matter to be decided. That the business of common carriers by rail is in a sense a public business because of the interest of society in the continued operation and rightful conduct of such business and that the public interest begets a public right of regulation to the full extent necessary to secure and protect it, is settled by so many decisions, state and federal, and is illustrated by such a continuous exertion of state and federal legislative power as to leave no room for question on the subject. It is also equally true that as the right to fix by agreement between the carrier and its employees a standard of wages to control their relations is primarily private, the establishment and giving effect to such agreed on standard is not subject to be controlled or prevented by public authority. But taking all these propositions as undoubted, if the situation which we have described and with which the act of Congress dealt be taken into view, that is, the dispute between the employers and employees as to a standard of wages, their failure to agree, the resulting absence of such standard, the entire interruption of interstate commerce which was threatened, and the infinite injury to the public interest which was imminent, it would seem inevitably to result that the power to regulate necessarily obtained and was subject to be applied to the extent necessary to provide a remedy for the situation, which included the power to deal with the dispute, to provide by appropriate action for a standard of wages to fill the want of one caused by the failure to exert the private right on the subject and to give effect by appropriate legislation to the regulations thus adopted. This must be unless it can be said that the right to so regulate as to save and

protect the public interest did not apply to a case where the destruction of the public right was imminent as the result of a dispute between the parties and their consequent failure to establish by private agreement the standard of wages which was essential; in other words that the existence of the public right and the public power to preserve it was wholly under the control of the private right to establish a standard by agreement. Nor is it an answer to this view to suggest that the situation was one of emergency and that emergency cannot be made the source of power. *Ex parte Milligan*, 4 Wall. 2. The proposition begs the question, since although an emergency may not call into life a power which has never lived, nevertheless emergency may afford a reason for the exertion of a living power already enjoyed. If acts which, if done, would interrupt, if not destroy, interstate commerce may be by anticipation legislatively prevented, by the same token the power to regulate may be exercised to guard against the cessation of interstate commerce threatened by a failure of employers and employees to agree as to the standard of wages, such standard being an essential prerequisite to the uninterrupted flow of interstate commerce.

But passing this, let us come to briefly recapitulate some of the more important of the regulations which have been enacted in the past in order to show how necessarily the exertion of the power to enact them manifests the existence of the legislative authority to ordain the regulation now before us, and how completely the whole system of regulations adopted in the past would be frustrated or rendered unavailing if the power to regulate under the conditions stated which was exerted by the act before us was not possessed. That regulation gives the authority to fix for interstate carriage a reasonable rate subject to the limitation that rights of private property may not be destroyed by establishing them on a confiscatory basis, is settled by long practice and decisions. That the power to regulate also extends to many phases of the business of carriage and embraces the right to control the contract power of the carrier in so far as the public interest requires such limitation, has also been manifested by repeated acts of legislation as to bills of lading, tariffs and many other things too numerous to mention. Equally certain is it that the power has been exercised so as to deal not only with the carrier, but with its servants and to regulate the relation of such servants not only with their employers, but between themselves. Illustrations of

the latter are afforded by the Hours of Service Act, the Safety Appliance Act, and the Employers' Liability Act. Clear also is it that an obligation rests upon a carrier to carry on its business and that conditions of cost or other obstacles afford no excuse and exempt from no responsibility which arises from a failure to do so and also that government possesses the full regulatory power to compel performance of such duty.

In the presence of this vast body of acknowledged powers there would seem to be no ground for disputing the power which was exercised in the act which is before us so as to prescribe by law for the absence of a standard of wages caused by the failure to exercise the private right as a result of the dispute between the parties, that is, to exert the legislative will for the purpose of settling the dispute and bind both parties to the duty of acceptance and compliance to the end that no individual dispute or difference might bring ruin to the vast interests concerned in the movement of interstate commerce, for the express purpose of protecting and preserving which the plenary legislative authority granted to Congress was reposed. This result is further demonstrated, as we have suggested, by considering how completely the purpose intended to be accomplished by the regulations which have been adopted in the past would be rendered unavailing or their enactment inexplicable if the power was not possessed to meet a situation like the one with which the statute dealt. What would be the value of the right to a reasonable rate if all movement in interstate commerce could be stopped as a result of a mere dispute between the parties or their failure to exert a primary private right concerning a matter of interstate commerce? Again, what purpose would be subserved by all the regulations established to secure the enjoyment by the public of an efficient and reasonable service, if there was no power in government to prevent all service from being destroyed? Further yet what benefits would flow to society by recognizing the right, because of the public interest, to regulate the relation of employer and employee and of the employees among themselves and to give to the latter peculiar and special rights safeguarding their persons, protecting them in case of accident and giving efficient remedies for that purpose, if there was no power to remedy a situation created by a dispute between employers and employees as to rate of wages, which if not remedied, would leave the public helpless, the whole people ruined and all the homes of the land submitted to a danger of the most serious charac-

ter? And finally, to what derision would it not reduce the proposition that government had power to enforce the duty of operation, if that power did not extend to doing that which was essential to prevent operation from being completely stopped by filling the interregnum created by an absence of a conventional standard of wages because of a dispute on that subject between the employers and employees by a legislative standard binding on employers and employees for such a time as might be deemed by the legislature reasonably adequate to enable normal conditions to come about as the result of agreements as to wages between the parties?

We are of opinion that the reasons stated conclusively establish that from the point of view of inherent power the act which is before us was clearly within the legislative power of Congress to adopt, and that in substance and effect it amounted to an exertion of its authority under the circumstances disclosed to compulsorily arbitrate the dispute between the parties by establishing as to the subject matter of that dispute a legislative standard of wages operative and binding as a matter of law upon the parties,—a power none the less efficaciously exerted because exercised by direct legislative act instead of by the enactment of other and appropriate means providing for the bringing about of such result. If it be conceded that the power to enact the statute was in effect the exercise of the right to fix wages where by reason of the dispute there had been a failure to fix by agreement, it would simply serve to show the nature and character of the regulation essential to protect the public right and safeguard the movement of interstate commerce, not involving any denial of the authority to adopt it.

And this leaves only to be generally considered whether the right to exercise such a power under the conditions which existed was limited or restrained by the private rights of the carriers or their employees.

(a) *As to the carrier*. As engaging in the business of interstate commerce carriage subjects the carrier to the lawful power of Congress to regulate irrespective of the source whence the carrier draws its existence, and as also by engaging in a business charged with a public interest all the vast property and every right of the carrier become subject to the authority to regulate possessed by Congress to the extent that regulation may be exerted considering the subject regulated and what is appropriate and relevant thereto,

it follows that the very absence of the scale of wages by agreement and the impediment and destruction of interstate commerce which was threatened called for the appropriate and relevant remedy, the creation of a standard by operation of law binding upon the carrier.

(b) *As to the employee.* Here again it is obvious that what we have previously said is applicable and decisive, since whatever would be the right of an employee engaged in a private business to demand such wages as he desires, to leave the employment if he does not get them and by concert of action to agree with others to leave upon the same condition, such rights are necessarily subject to limitation when employment is accepted in a business charged with a public interest and as to which the power to regulate commerce possessed by Congress applied and the resulting right to fix in case of disagreement and dispute a standard of wages as we have seen necessarily obtained.

In other words, considering comprehensively the situation of the employer and the employee in the light of the obligations arising from the public interest and of the work in which they are engaged and the degree of regulation which may be lawfully exerted by Congress as to that business, it must follow that the exercise of the lawful governmental right is controlling. This results from the considerations which we have previously pointed out and which we repeat, since conceding that from the point of view of the private right and private interest as contradistinguished from the public interest the power exists between the parties, the employers and employees, to agree as to a standard of wages free from legislative interference, that right in no way affects the lawmaking power to protect the public right and create a standard of wages resulting from a dispute as to wages and a failure therefore to establish by consent a standard. The capacity to exercise the private right free from legislative interference affords no ground for saying that legislative power does not exist to protect the public interest from the injury resulting from a failure to exercise the private right. In saying this of course it is always to be borne in mind that as to both carrier and employee the beneficent and ever-present safeguards of the Constitution are applicable and therefore both are protected against confiscation and against every act of arbitrary power which if given effect to would amount to a denial of due process or would be repugnant to any other constitutional right. And this emphasizes that there is

no question here of purely private right since the law is concerned only with those who are engaged in a business charged with a public interest where the subject dealt with as to all the parties is one involved in that business and which we have seen comes under the control of the right to regulate to the extent that the power to do so is appropriate or relevant to the business regulated.

Having thus adversely disposed of the contentions as to the inherent want of power, we come to consider all the other propositions which group themselves under a common heading, that is,

II. *Such an abuse of the power if possessed as rendered its exercise unconstitutional.*

We shall consider the various contentions which come under this heading under separate subdivisions.

(a) *Equal protection of the laws and penalties.*

The want of equality is based upon two considerations. The one is the exemption of certain short line and electric railroads. We dismiss it because it has been adversely disposed of by many previous decisions. The second rests upon the charge that unlawful inequality results because the statute deals not with all, but only with the wages of employees engaged in the movement of trains. But such employees were those concerning whom the dispute as to wages existed, growing out of which the threat of interruption of interstate commerce arose,—a consideration which establishes an adequate basis for the statutory classification.

As to the penalties it suffices to say that in this case a recovery of penalties is not asked and consequently the subject may well be postponed until it actually arises for decision.

(b) *Want of due process resulting from the improvidence with which the statute was enacted and the impossibility in practice of giving effect to its provisions; in other words, as stated in the argument, its "unworkability."*

The contention virtually is that, conceding the legislative power under the circumstances stated to fix a standard of wages, such authority necessarily contemplates consideration before action and not a total and obvious disregard of every right of the employer and his property,—a want of consideration and a disregard which, it is urged, appear on the face of the statute and which cause it therefore to amount to a decision without a hearing and to a mere arbitrary bestowal of millions by way of wages upon employees to the injury not only of the employer but of the public upon whom the burden must necessarily fall. Upon the assump-

tion that unconstitutionality would result if there be ground for the propositions, let us test them. In the first place, as we have seen, there is no room for question that it was the dispute between the parties, their failure to agree as to wages and the threatened disruption of interstate commerce caused by that dispute which was the subject which called for the exertion of the power to regulate commerce and which was dealt with by the exertion of that power which followed. In the second place, all the contentions as to want of consideration sustaining the action taken are disposed of by the history we have given of the events out of which the controversy grew, the public nature of the dispute, the interposition of the President, the call by him upon Congress for action in conjunction with the action taken, all demonstrating not unwitting action or a failure to consider, whatever may be the room, if any, for a divergence of opinion as to the want of wisdom shown by the action taken.

But to bring the subject to a closer analysis, let us briefly recall the situation, the conditions dealt with and the terms of the statute. What was the demand made by the employees? A permanent agreement as to wages by which the period should be shortened in which the fixed mileage task previously existing should be performed, an allowance to be made of extra pay by the minute at one and one-half times the regular pay for any overtime required to perform the task if it was not done in the reduced time, with a condition that no reduction in wages should occur from putting the demands into effect and also that in that event their operation should be binding upon the employers and optional on the employees. What was the real dispute? The employers insisted that this largely increased the pay because the allotted task would not be performed in the new and shorter time and a large increase for overtime would result. The employees on the other hand insisted that as the task would be unchanged and would be performed in the shorter hours, there would be no material, or at all events no inordinate, increase of pay. What did the statute do in settling these differences? It permanently applied an eight-hour standard for work and wages which existed and had been in practice on about fifteen per cent of the railroads. It did not fix the amount of the task to be done during those hours, thus leaving that to the will of the parties. It yielded in part to the objections of the employers by permitting overtime only if "necessary" and it also absolutely rejected in favor of the employers and against

the employees the demand for an increased rate of pay during overtime if there was any and confined it to the regular rate and it moreover rejected the option in favor of the employees by making the law obligatory upon both parties. In addition, by the provision prohibiting a lower rate of wages under the new system than was previously paid, it fixed the wages for such period. But this was not a permanent fixing, but in the nature of things a temporary one which left the will of the employers and employees to control at the end of the period if their dispute had then ceased.

Considering the extreme contentions relied upon in the light of this situation we can discover no basis upon which they may rest. It certainly is not afforded because of the establishment of the eight-hour standard, since that standard was existing as we have said on about fifteen per cent of the railroads, had already been established by act of Congress as a basis for work on government contracts, and had been upheld by this court in sustaining state legislation. It certainly cannot be said that the act took away from the parties, employers and employees, their private right to contract on the subject of a scale of wages since the power which the act exerted was only exercised because of the failure of the parties to agree and the resulting necessity for the lawmaking will to supply the standard rendered necessary by such failure of the parties to exercise their private right. Further, in view of the provisions of the act narrowing and limiting the demands made, the statute certainly affords no ground for the proposition that it arbitrarily considered only one side of the dispute to the absolute and total disregard of the rights of the other, since it is impossible to state the modifications which the statute made of the demands without by the very words of the statement manifesting that there was an exertion of legislative discretion and judgment in acting upon the dispute between the parties. How can this demonstration fail to result if it be stated that the scope of the task to be performed in the eight-hour period was not expressed but was left therefore to adjustment between the parties, that overtime was only permitted if "necessary," and that extra pay for overtime was rejected and regular rate of pay substituted?

Conceding that there would necessarily result from the enforcement of the statute an increase of pay during the period for which the statute forbade a reduction, such concession would not bring the statute within the grounds stated. The right to meet the situation caused by the dispute and to fix a standard which should

be binding upon both parties included of course the legislative authority to take into consideration the elements of difference and in giving heed to them all to express such legislative judgment as was deemed best under the circumstances.

From this it also follows that there is no foundation for the proposition that arbitrary action in total disregard of the private rights concerned was taken because the right to change or lower the wages was left to be provided for by agreement between the parties after a reasonable period which the statute fixed. This must be unless it can be said that to afford an opportunity for the exertion of the private right of agreement as to the standard of wages was in conflict with such right.

When it is considered that no contention is made that in any view the enforcement of the act would result in confiscation, the misconception upon which all the propositions proceed becomes apparent. Indeed in seeking to test the arguments by which the propositions are sought to be supported we are of opinion that it is evident that in substance they assert not that no legislative judgment was exercised, but that, in enacting the statute there was an unwise exertion of legislative power begotten either from some misconception or some mistaken economic view or partiality for the rights of one disputant over the other or some unstated motive which should not have been permitted to influence action. But to state such considerations is to state also the entire want of judicial power to consider them,—a view which therefore has excluded them absolutely from our mind and which impels us as a duty to say that we have not in the slightest degree passed upon them. While it is a truism to say that the duty to enforce the Constitution is paramount and abiding, it is also true that the very highest of judicial duties is to give effect to the legislative will and in doing so to scrupulously abstain from permitting subjects which are exclusively within the field of legislative discretion to influence our opinion or to control judgment.

Finally we say that the contention that the act was void and could not be made operative because of the unworkability of its provisions is without merit, since we see no reason to doubt that if the standard fixed by the act were made applicable and a candid effort followed to carry it out, the result would be without difficulty accomplished. It is true that it might follow that in some cases because of particular terms of employment or exceptional surroundings some change might be necessary, but these exceptions

afford no ground for holding the act void because its provisions are not susceptible in practice of being carried out.

Being of the opinion that Congress had the power to adopt the act in question, whether it be viewed as a direct fixing of wages to meet the absence of a standard on that subject resulting from the dispute between the parties or as the exertion by Congress of the power which it undoubtedly possessed to provide by appropriate legislation for compulsory arbitration—a power which inevitably resulted from its authority to protect interstate commerce in dealing with a situation like that which was before it—we conclude that the court below erred in holding the statute was not within the power of Congress to enact and in restraining its enforcement and its decree therefore must be and it is reversed and the cause remanded with directions to dismiss the bill.

And it is so ordered. . . .

2. Wage Adjustments

A. RAILROAD LABOR BOARD DECISION NO. 2 [1]

This decision is upon a controversy or dispute between the organizations of employees of carriers and the carriers named below. The subject matter of the dispute is what shall constitute just and reasonable wages and working conditions on these carriers. In March, 1920, pursuant to the Transportation Act, the dispute was considered in conference between representatives of the parties and not having been there decided was referred by them to this Board.

This decision is upon that portion of the dispute which covers wages and does not deal with working conditions. The organizations parties hereto are:

International Association of Machinists.

International Alliance of Amalgamated Sheet Metal Workers.

Brotherhood of Locomotive Engineers.

Brotherhood of Railroad Trainmen.

Brotherhood of Railway and Steamship Clerks, Freight Handlers, Express and Station Employes.

Switchmen's Union of North America.

Brotherhood of Stationary Firemen and Oilers.

Brotherhood of Railroad Signalmen of America.

[1] *International Association of Machinists et al. v. Atchison, Topeka and Santa Fe Railway et al.*, Decisions of United States Railroad Labor Board, vol. 1, p. 13 (July 20, 1920). See Jones, pp. 460–464, 470–471, 565–566, and Vanderblue and Burgess, pp. 381–383.

Railway Employes' Department, American Federation of Labor.

United Brotherhood of Maintenance of Way Employes and Railway Shop Laborers.

Order of Railroad Telegraphers.

Brotherhood Railway Carmen of America.

International Brotherhood of Electrical Workers.

Brotherhood of Locomotive Firemen and Enginemen.

Order of Railway Conductors.

International Brotherhood of Boilermakers, Iron Ship Builders and Helpers of America.

International Brotherhood of Blacksmiths, Drop Forgers and Helpers.

National Association Masters, Mates and Pilots of America.

The carriers parties to the dispute are named in Article I of this decision.

A number of carriers, including many so-called "short lines," are not parties. Hence they are not directly affected by this decision. Any dispute between them and their employees, when properly brought before this Board, will be heard at an early date.

A statement of the origin and nature of the controversy follows.

On December 28, 1917, the President, as a war measure, under the Possession and Control Act of August 29, 1916, took over and operated through the Director General of Railroads approximately 93 per cent of the railroad mileage of the country. The Transportation Act of February 28, 1920, terminated Federal control and on March 1 these railroads reverted to their owners.

From August, 1914, to December, 1917, the wages of railroad employees remained substantially unaltered. By December, 1917, the social and industrial changes which accompanied the World War had thrown such wages seriously out of line with those in other industries and with the cost of living. A short time prior to Federal control, organizations of railroad employees presented to the managements requests for substantial increases. The Director General on January 10, 1918, appointed the Lane Commission, referred these requests to it, and empowered it to investigate the compensation of railroad employees and to make such recommendations as should be deemed proper. On the basis of the Commission's report, the Director General's Order No. 27 was promulgated on May 25, 1918. It increased the pay of railway employees then receiving less than $250 per month by percentages graduated from 43 per cent to the lower-paid employees to zero per cent to those receiving

salaries of $249 per month. The principle back of this order was thus stated in the Lane report: "In fairness a sufficient increase should be given to maintain that standard of living which obtained in the pre-war period . . . and upon those who can best afford to sacrifice should be cast the greater burden."

General Order No. 27 was based upon the cost of living at the time it was formulated. These costs, however, continued to rise through the years 1918 and 1919. In January, 1919, the shop crafts and thereafter other railroad employees presented requests for further wage increases aggregating some $800,000,000 per annum. The Director General transmitted these requests to the President, who, on August 25, 1919, urged the employees to refrain from pressing them, pending a better opportunity to estimate the permanence of high living costs.

In February, 1920, these costs having continued to rise and a reasonable time for the appearance of a trend toward lower living costs having elapsed, the organizations of railroad employees renewed their requests for wage increases to the Director General, who declined to act, and was supported by the President in so doing in view of the approaching termination of Federal control. The President, however, on February 13, agreed to use his influence toward the establishment by Congress of legal machinery to deal with controversies between the carriers and their employees. On February 28, 1920, the Transportation Act became law. This Act provides for the appointment by the President of a Railroad Labor Board which shall decide disputes with reference to wages and working conditions of railroad employees. Section 301 of the act provides that all such disputes shall be considered and, if possible, decided in conference between representatives of the carrier concerned and representatives of its employees. At the suggestion of the President, the requests for increases in wages and for changes in working conditions submitted to the Director General in February were the subject of conference between representatives of the carriers and of the organizations concerned. This conference extended from March 10 to April 1, 1920, but resulted in complete failure to agree.

This long delay and succession of disappointments, coupled with the pressure of a further rise in living costs, produced deep and not unreasonable dissatisfaction on the part of railroad employees, who felt themselves called on to make sacrifices, as they believed, far beyond those of any other class. Nevertheless, the great majority

have continued to serve and to conduct the transportation of the country, awaiting with disciplined and patriotic patience the reduction of living costs, the decision of the Director General on their requests, the action of Congress, the conclusions of the conference, the appointment of this Board, the presentation of evidence to it, and this decision. Eighteen months will have elapsed when this decision is rendered from the original presentation in January, 1919, of the first of the requests which it in part determines. For these reasons and as a measure of justice it was decided and announced by this Board on June 12 that this decision, when made, would be effective as of May 1, 1920 and would apply according to the time served to all employees who were in the service as of May 1 and who have remained therein or who have come into the service since and remained therein.

The Board, on the day after its members were confirmed by the Senate (April 15, 1920), received the controversy which had been so long pending and which had remained so long unsettled in spite of the efforts and conferences noted above. From that day until the date of this decision it has been constantly and assiduously engaged in receiving evidence, hearing arguments, reading and considering the many volumes of testimony offered and the many thousands of pages of exhibits and statements. Approximately 2,000,000 men, comprehended in more than 1,000 classifications, are affected by this decision. It is believed that few more serious, difficult, and intricate problems have been presented to tribunals of this country.

In arriving at its decision the Board has taken into consideration, as the Transportation Act prescribes—

(1) The scale of wages paid for similar kinds of work in other industries;

(2) The relation between wages and the cost of living;

(3) The hazards of the employment;

(4) The training and skill required;

(5) The degree of responsibility;

(6) The character and regularity of the employment; and

(7) Inequalities of increase in wages or of treatment, the result of previous wage orders or adjustments.

Besides the circumstances set out above, the act provides the Board shall consider in determining wages "other relevant circumstances." This, it understands, comprehends, among other things, the effect the action of this Board may have on other wages and in-

dustries, on production generally, the relation of railroad wages to the aggregate of transportation costs and requirements for betterments, together with the burden on the entire people of railroad transportation charges.

The Board has been unable to find any formula which, applied to the facts, would work out a just and reasonable wage for the many thousands of positions involved in this dispute. The determination of such wages is necessarily a matter of estimate and judgment in view of all the conditions, a matter on which individuals will differ widely as their information or lack of it, their interest, situation, and bias may influence them.

Those persons who consider the rates determined on herein too high should reflect on the abnormal conditions resulting from the high cost of living and the high rates now being paid in other industry. The employees who may believe these rates too low should consider the increased burden these rates will place on their fellow countrymen, many of whom are less favorably situated than themselves.

The Board has considered the seven circumstances suggested by the act. "The hazards of the employment," "the training and skill required," and "the degree of responsibility" were well presented by the representatives of the employees and of the carriers. These factors are recognized by all and have had due weight. With reference to "the character and regularity of the employment," the Board finds that with few exceptions railroad employment is more regular and the character of the work is more desirable than like occupations outside. As a rule railroad employees are such for life and usually remain for years with the same company. This permanence of employment has certain advantages which have been considered by the Board. As to "inequalities of increase in wages or of treatment, the result of previous wage orders or adjustment," the urgency of prompt action has made elaborate investigation into this factor impracticable. It has, however, been considered. With regard to "the scale of wages paid for similar kinds of work in other industries," and "the relation between wages and the cost of living," the Board has been under some difficulty. It is clear that the cost of living in the United States has increased approximately 100 per cent since 1914. In many instances, the increases to employees herein fixed, together with prior increases granted since 1914, exceed this figure. The cost of living and wages paid for similar kinds of work in other industries, however, differ

as between different parts of the country. Yet standardization of pay for railroad employees has proceeded so far and possesses such advantages that it was deemed inexpedient and impracticable to establish new variations based on these varying conditions.

For the reasons stated it was necessary to adopt the method of determining what, if any, increases over existing wages (established under the authority of the United States Railroad Administration) would constitute a reasonable and just wage for the hundreds of classifications of railroad employees. By so doing such differences in present rates as are the result of local differences are preserved together with (in general) the differentials between different classes of employees which have come about in the railroad service and which may be considered prima facie to be based on good reason. It is believed that this method accomplishes that approximation to justice which is practicable in human affairs.

The Board has endeavored to fix such wages as will provide a decent living and secure for the children of the wage earners opportunity for education, and yet to remember that no class of Americans should receive preferred treatment and that the great mass of the people must ultimately pay a great part of the increased cost of operation entailed by the increase in wages determined herein.

It has been found by this Board generally that the scale of wages paid railroad employees is substantially below that paid for similar work in outside industry, that the increase in living cost since the effective date of General Order No. 27 and its supplements has thrown wages below the prewar standard of living of these employees, and that justice as well as the maintenance of an essential industry in an efficient condition require a substantial increase to practically all classes.

The American people desire and must have transportation adequate to their needs. They also wish to do justice to men employed in the public service whether on public utilities or otherwise. Wage scales which are insufficient to attract or support men of the character necessary for railroad work constitute waste and extravagance and not economy. Transportation can not be efficient unless the personnel throws itself into its work with the devotion which public service ought to inspire, and no such devotion can exist in the minds of men who feel themselves treated with injustice. It is hoped that the present decision, which adds substantial amounts to present wages, will be felt to be just and equitable under all the circumstances and railroad employees will accordingly render the

best service of which they are capable. If they will do this, it is believed the American people will receive benefits far outweighing the cost of the increases decided upon herein.

It is believed that if the keen intelligence of railroad employees and managers alike is fired by an eagerness to serve the people and a spirit of cooperation to that end is brought about, such economies of material and labor, such improvements in method and workmanship, such solutions of transportation problems will result as will offset a great part of the increase of wages provided for herein and that the people will thus be relieved of a part of the burden of these increases. They deserve and have a right to expect this spirit.

During the hearings the International Association of Railroad Supervisors of Mechanics and The American Train Dispatchers Association have been made parties to this dispute. In granting hearings to them, this Board has not assumed or decided any question of jurisdiction between the several organizations or associations either parties to or outside of this dispute.

There are in the dispute as presented questions involving rules and working conditions, some of which are interwoven with and materially affect earnings and wages. Adequate investigation and consideration of these questions would demand time. Existing conditions required that the Board should make as early decision of the wage question as practicable. For that reason, it has been necessary—and both parties to the controversy have indicated it to be their judgment and wish—that the Board should separate the question involving rules and working conditions from the wage questions. Accordingly, the Board has not undertaken herein to consider or change the rules and agreements now existing or in force by the authority of the United States Railroad Administration or otherwise, and this decision will be so understood and applied.

The Board assumes as the basis of this decision the continuance in full force and effect of the rules, working conditions, and agreements in force under the authority of the United States Railroad Administration. Pending the presentation, consideration, and determination of the questions pertaining to the continuation or modification of such rules, conditions, and agreements, no changes therein shall be made except by agreement, between the carrier and employees concerned. As to all the questions with reference to the continuation or modification of such rules, working

conditions, and agreements, further hearings will be had at the earliest practicable date, and decision thereon will be rendered as soon as adequate consideration can be given.

It is further declared that this Board, finding it necessary to adopt a basis for the rates and advances decided on, has adopted the rates established by or under the authority of the United States Railroad Administration. The intent of this decision is that the named increase, except as otherwise stated, shall be added to the rate of compensation established by and under the authority of the United States Railroad Administration.

The decision of the Board is the result of the action of the Board, composed of nine members, acting as a body under the usual parliamentary methods of procedure and its own rules. Each and every separate question was considered and voted upon, each and every rate for each class was voted upon and adopted by a majority vote of the Board, and in every instance one or more of the public group, as the law requires, voted in the affirmative on any classification or rate adopted.

In a problem so complex and involving the inter-relationship of the wages of so many different classes of employees, it is obvious that there could not be unanimous agreement among all the members of the Board on all increases fixed by this decision; but inasmuch as the several increases hereinafter set forth represent, in each instance, the best judgment of the majority of the Board it is believed that no useful purpose would be served by setting forth the views held by the members who for one or another reason dissented from particular increases. This statement is made in order that it may not be inferred that the decision, in all its details, states the precise increase which any one of the members hereof might have stated if he had the sole power and responsibility for fixing such increase.

This Board estimates that the increase in wages herein provided for will impose on the railroads an addition to the pay roll of March 1, 1920, aggregating approximately $600,000,000 per annum.

The Board appreciates that some time will necessarily be required for computing back pay from May 1. This is work of a kind which must be done by regular employees, familiar with the classifications, rates, and rules.

The Board believes that the railroads will proceed with diligence in the matter. It urges upon them that there be no unnecessary

delay; and it urges equally upon the employees that they exercise patience and refrain from unreasonable pressure or criticism..

The Board decides upon the present dispute and submission that the rates of increase set out below, added and applied to the rates established for the positions specified by or under the authority of the United States Railroad Administration, constitute, for the said positions on carriers named herein, a just and reasonable wage.

The Board also decides that the rates set out below constitute for the positions specified on carriers named herein a just and reasonable wage.

ARTICLE I.—RAILROADS AFFECTED.

. . . .

ARTICLE II.—CLERICAL AND STATION FORCES.

. . . .

ARTICLE III.—MAINTENANCE OF WAY AND STRUCTURES AND UNSKILLED FORCES SPECIFIED.

Add to the rates established by or under the authority of the United States Railroad Administration, for each of the hereinafter-named classes, the following amounts per hour:

	Cents.
Sec. 1. Building, bridge, painter, construction, mason and concrete, water supply, and plumber foremen, except such water supply and plumber foremen as were paid under the provisions of Supplement No. 4 to General Order No. 27	15
Sec. 2. Assistant building, bridge, painter, construction, mason and concrete, water supply, and plumber foremen, and for coal wharf, coal chute, and fence gang foremen, pile driver, ditching and hoisting engineers and bridge inspectors, except such assistant water supply and plumber foremen as were paid under the provisions of Supplement No. 4 to General Order No. 27	15
Sec. 3. Section, track, and maintenance foremen, and assistant section, track, and maintenance foremen	15
Sec. 4. Mechanics in the maintenance of way and bridge and building departments, except those that come under the provisions of the national agreement with the Federated Shop Trades	15
Sec. 5. Mechanics' helpers in the maintenance of way and bridge and building departments, except those that	

	Cents.
come under the provisions of the national agreement with the Federated Shop Trades	$8\frac{1}{2}$
Sec. 6. Track laborers, and all common laborers in the maintenance of way department and in and around shops and roundhouses, not otherwise provided for herein	$8\frac{1}{2}$
Sec. 7. Drawbridge tenders and assistants, pile-driver, ditching and hoisting firemen, pumper engineers and pumpers, crossing watchmen or flagmen, and lamp lighters and tenders	$8\frac{1}{2}$
Sec 8. Laborers employed in and around shops and roundhouses, such as engine watchmen and wipers, fire builders, ash-pit men, flue borers, coal passers (except those coming under the provisions of Article VIII, section 3, this decision), coal-chute men, etc.	10

ARTICLE IV.—SHOP EMPLOYEES.

Add to the rates established by or under the authority of the United States Railroad Administration, for each of the hereinafter-named classes, the following amounts per hour:

	Cents.
Sec. 1. Supervisory forces	13
Sec. 2. Machinists, boiler makers, blacksmiths, sheet-metal workers, electrical workers, carmen, molders, cupola tenders, and core makers, including those with less than four years' experience, all crafts	13
Sec. 3. Regular and helper apprentices and helpers, all classes	13
Sec. 4. Car cleaners	5

. . . .

ARTICLE XIII.—GENERAL APPLICATION.

Section 1. The increases in wages and the rates hereby established shall be effective as of May 1, 1920, and are to be paid according to the time served to all who were then in the carriers' service and remained therein or who have since come into such service and remained therein.

Sec. 2. The provisions of this decision will not apply in cases where amounts less than $30 per month are paid to individuals for special service which takes only a portion of their time from outside employment or business.

Sec. 3. Increases specified in this decision are to be added to the hourly rates as established by or under the authority of the

United States Railroad Administration for employees now being paid by the hour. For employees paid by the day, add eight times the hourly increase specified to the daily rate. For employees paid by the month, add 204 times the hourly rate specified to the monthly rate.

SEC. 4. Each carrier will in payment to employees on and after August 1, 1920, include therein the increases in wages and the rates hereby established.

SEC. 5. The amounts due in back pay from May 1, 1920, to July 31, 1920, inclusive, in accordance with the provisions of this decision, will be computed and payment made to the employees separately from the regular monthly or semimonthly payments, so that employees will know the exact amount of their back payments.

Recognizing the clerical work necessary to make these computations for back pay and the probable delay before the entire period can be covered, each month, beginning with May, 1920, shall be computed as soon as practicable and, as soon as completed, payment shall be made.

SEC. 6. The increases in wages and the rates hereby established shall be incorporated in and become a part of existing agreements or schedules.

SEC. 7. Except as specifically modified herein, the rules regulating payments of overtime or working conditions in all branches of service, and the established and accepted methods of computing time and compensation thereunder, shall remain in effect until or unless changed in the manner provided by the Transportation Act, 1920.

SEC. 8. It is not intended in this decision to include or fix rates for any officials of the carriers affected except that class designated in the Transportation Act of 1920 as "subordinate officials," and who are included in the act as within the jurisdiction of this Board. The act provides that the term "subordinate officials" includes officials of carriers of such class or rank as the Interstate Commerce Commission shall designate by regulation duly formulated and issued. Hence, whenever in this decision words are used, such as "foremen," "supervisor," etc., which may apply to officials, such words are intended to apply to only such classes of subordinate officials as are now or may hereafter be defined and classified by the Interstate Commerce Commission as such subordinate officials.

ARTICLE XIV.—INTERPRETATION OF THIS DECISION.

SECTION 1. Should a dispute arise between the management and the employees of any of the carriers as to the meaning or intent of this decision which can not be decided in conference between the parties directly interested, such dispute shall be referred to the United States Railroad Labor Board in the manner provided by the Transportation Act, 1920.

SEC. 2. All such disputes shall be presented in a concrete joint signed statement setting forth (1) the article of this decision involved, (2) the facts in the case, (3) the position of the employees, and (4) the position of the management thereon. Where supporting documentary evidence is used it shall be attached in the form of exhibits.

SEC. 3. Such presentations shall be transmitted to the secretary of the United States Railroad Labor Board, who shall place same before the Board for final disposition.

B. RAILROAD LABOR BOARD DECISION NO. 1267.[1]

Subject of the dispute.—This decision is upon a series of controversies or disputes between the carriers and the classes of employees represented by the organizations, named below. The subject matter of this dispute is what shall constitute just and reasonable wages.

Parties to the dispute.—(1) The carriers parties hereto, each of which has a dispute with one or more of the organizations hereinafter named, are:

. . . .

(2) The organizations parties hereto, each of which has a dispute with one or more of the above-named carriers, are:

United Brotherhood of Maintenance of Way Employees and Railway Shop Laborers,

Brotherhood of Railroad Station Employees.

Nature of the proceedings.—In conformity with the provisions of the transportation act, 1920, the carriers or employees named herein have held or attempted to hold conferences on the subject matter of this dispute, and all controversies not having been de-

[1] *United Brotherhood of Maintenance of Way Employees and Railway Shop Laborers et al.* v. *Alabama and Vicksburg Railway Co. et al.*, Decisions of United States Railroad Labor Board, vol. 3, p. 767 (October 21, 1922). See Jones, pp. 580, 585–586, and Vanderblue and Burgess, pp. 391–394.

cided in such conferences were referred to the United States Railroad Labor Board for decision.

Both parties made a full presentation to the Labor Board of their respective contentions by testimony and argument, oral and written.

History of the controversy.—In the month of March, 1922, there was presented to the Labor Board the evidence upon which was subsequently based Decision No. 1028, establishing the wages of the classes of employees represented by the United Brotherhood of Maintenance of Way Employees and Railway Shop Laborers. Decision No. 1028 was protested by the employees and they have petitioned the board for an increase in wages, based, first, upon a reconsideration of the evidence presented in said decision and secondly, upon the contention that changes in industrial conditions since March justify an increase.

In so far as the petition of the employees seeks a revision of Decision No. 1028, it is denied, a majority of the board being of the opinion that said decision was just and reasonable.

That portion of the petition which asks for a wage increase on the ground that industrial conditions have undergone changes since the evidence was submitted, upon which Decision No. 1028 was predicated, is granted to the extent herein below set out. It has not heretofore occurred that the board has handed down a decision either increasing or decreasing wages after the lapse of such a short period as three and one-half months since the effective date of a former decision, but the evidence in this case is so clear and satisfactory as to justify promptness of action.

Perhaps, the sudden and unexpected fluctuations to which industry has been subjected since the war have not been more strikingly exemplified than by the sharp upturn of wages which began in April of this year in various industries affecting particularly common labor. When the evidence was submitted in March, upon which Decision No. 1028 was based, this upward wage-trend had not set in and could not with any certainty be anticipated.

The employees, in their Exhibit No. 2 herein, quote from the monthly wage bulletins of the National Industrial Conference Board the wage increases and decreases for certain months. Supplementing the figures there quoted by the corresponding figures taken from the bulletins of the same authority for other months, we have the following record of the number of wage increases and reductions reported for the respective months:

Monthly period.	*Increases.*	*Reductions.*
Feb. 15 to Mar. 15	0	35
Mar. 15 to Apr. 15	0	81
Apr. 15 to May 15	9	54
May 15 to June 15	26	23
June 15 to July 15	21	25
July 15 to Aug. 15	8	7
Aug. 15 to Sept. 15	119	4

While the foregoing is not all the evidence before the Labor Board on this point, it is typical.

Employees' Exhibit No. 2 also quotes from the June report of the Federal Reserve Bank of New York City in support of the proposition that there is a marked upward trend in wages. An excerpt from said quoted report reads as follows:

> The continued increase in the volume of business activity has been reflected in a marked change in the employment situation. Evidences of this change are found in a number of instances of wage increases which have resulted from shortages of workers, and in reports from employment agencies.
>
> Wage increases have been taking place, particularly in the case of common labor, which has been difficult to secure at the low wage rates which many firms adopted in the last few months.

Following this upward wage movement, the United States Steel Corporation increased its wages for unskilled labor on August 22 to 36 cents an hour. For more than a year previously it had been paying only 30 cents an hour. Many other steel companies followed with increases for common labor to rates of 35 cents and 36 cents an hour. Under this decision the minimum for common labor on a few roads will be 25 cents an hour and the minimum on others will be 37 cents an hour. The minimum of 25 cents will prevail in a very restricted territory and apply comparatively to a very small number of men. As a matter of fact, this 25-cent minimum is a higher wage than the 37-cent minimum, when considered in relation to the living conditions of the respective territories. This is evidenced in part by the fact that certain carriers in the territory where the high minimum prevails have been paying to common labor a wage slightly in excess—and a few have been paying a rate considerably in excess—of said minimum; for example, the New York, New Haven & Hartford Railroad Co. is paying 40 cents an hour to trackmen. On the other hand, cer-

tain roads in the southeastern territory had been paying for some months prior to the issuance of Decision No. 1028 and are still paying a rate to common labor considerably lower than the lowest minimum fixed by the Labor Board for other carriers in the same territory, but this has been by agreement with the employees. Examples of this are the contracts on the following roads at the rates indicated for section men and other common labor:

Charleston & Western Carolina Ry	$0.175
Central of Georgia Railway Co	.18
Atlantic Coast Line Railroad Co	.18 .20
Mobile & Ohio Railroad Co	.20 .21 .22

The territorial differentials established in 1918 have not yet been disturbed by any of the decisions of the Labor Board and are not changed by the present decision.

The Labor Board in its present decision considers all the seven elements or factors set out in the transportation act, 1920, for its guidance in fixing just and reasonable wages, but lays special stress upon the first, which reads as follows: "The scales of wages paid for similar kinds of work in other industries."

As to the cost of living, the reports of the Bureau of Labor Statistics show that there has been no pronounced change since March, 1922. The June report shows a slight decrease in the cost of living for the previous quarter—namely, two-tenths of 1 per cent. The September quarterly report again shows a decrease of two-tenths of 1 per cent.

In view of these facts and circumstances and all the evidence adduced in this case, the Labor Board is of the opinion that a conservative increase of wages is clearly due to the three groups of unskilled labor and to the section foremen.

Certain carriers have raised the question in this case that a portion of the employees embraced in the class herein involved are on strike on their respective properties and are therefore not entitled to be heard before the board at this time. The fact that some of these employees are on strike does not preclude the organization from presenting a dispute in behalf of those employees who are actually in the service of the carrier. The employees in the service can not equitably be deprived of their right to appear before the Labor Board because others are out on strike.

In the case of certain carriers there are submissions before the

board from two rival organizations, in which both ask for wage increases. In such cases, it is not now necessary to pass upon the jurisdictional question involved.

Decision.—The Railroad Labor Board therefore decides:

1. That each of the carriers party to this dispute shall make increases in the rates of wages heretofore established by the authority of the United States Railroad Labor Board in Decision No. 1028 for the specific classes of its employees named or referred to in Article II in amounts hereinafter specified for the classes named in the schedule of increases.

2. That the scope of this decision is limited to the carriers named under Article II, to such carriers as may be included hereafter by addenda, and to the specific classes of employees named or referred to under each particular carrier.

3. That the increases in wages hereby authorized shall be effective as of October 16, 1922, and shall be made in accordance with the following articles, which establish the schedule of increases, designate the carriers and employees affected, and prescribe the method of general application.

ARTICLE I.—SCHEDULE OF INCREASES.

For the specific classes of employees listed herein and named or referred to in connection with a carrier affected by this decision, use the following schedule of increases per hour:

. . . .

MAINTENANCE OF WAY AND STRUCTURES, AND UNSKILLED FORCES SPECIFIED.

Section 1. Bridge, building, painter, construction, mason and concrete, water-supply, and plumber foreman (except water-supply and plumber foremen coming under the provisions of section 1 of Article IV, Decision No. 147) .... No increase.

Section 2. Assistant bridge, building, painter, construction, mason and concrete, water-supply, and plumber foremen, and for coal-wharf, coal-chute, and fence-gang foremen, pile-driver, ditching and hoisting engineers and bridge inspectors (except assistant water-supply and plumber foremen coming under the provisions of section 1 of Article IV, Decision No. 147) .... No increase.

Section 3. Section, track and maintenance foremen, and assistant section, track and maintenance foremen .... 2 cents.

Section 4. Mechanics in the maintenance of way and bridge and building departments (except those that come within the scope of agreements with the Federated Shop Crafts)..........................	No increase.
Section 5. Mechanics' helpers in the maintenance of way and bridge and building departments (except those that come within the scope of agreements with the Federated Shop Crafts)......................	No increase.
Section 6. Track laborers, and all common laborers in the maintenance of way department and in and around shops and roundhouses not otherwise provided for herein............................	2 cents.
Section 7. Drawbridge tenders and assistants, pile-driver, ditching and hoisting firemen, pumper engineers and pumpers, crossing watchmen or flagmen, and lamp lighters and tenders....................	2 cents.
Section 8. Laborers employed in and around shops and roundhouses, such as engine watchmen and wipers, fire builders, ash-pit men, flue borers, coal passers (except those coming under the provisions of section 3 of Article VIII, Decision No. 147), coal-chute men, etc...............................	2 cents.

. . . .

DISSENTING OPINION.

In dissenting from the decision of the majority, the undersigned refers to the dissenting opinions of the minority in Decisions Nos. 1028, 1036, and 1074, all of which are reaffirmed and to be considered as if reproduced herein.

The submissions filed by the employees in this dispute quite uniformly requested the restoration of the rates of pay established by Decision No. 2, and on August 28, 1922, this request was supplemented by the representative of the employees by the filing of a formal motion reading:

We wish formally to request that the living-wage principle be accepted by the board and made the basis of its action in the present case. We make this request as a formal motion and ask the board to take it under consideration and give us a formal ruling before we proceed further with the case:

1. That the board recognize the living wage as the basis of its decision in this case.

2. That in applying this principle a minimum rate of not less than 48 cents an hour be awarded to all of our members, who under your last wage Decision No. 1028 (Docket 1300) are receiving 28 cents an hour or less.

3. That for those who are now receiving more than 28 cents an hour, their differential in cents above 28 cents be added to the new minimum rate of 48 cents an hour. This will mean a minimum rate for our people of 48 cents an hour.

In deciding this request, two resolutions were offered, the first by the chairman, and the second by Mr. Wharton, reading as follows:

(1) By the chairman:

It is superfluous for the board to announce in advance the principle or theory upon which it will fix wages in the pending dispute. It may be assumed by the parties in this case that the board will give full consideration to every circumstance set out in the statute for its guidance, but it will not go beyond that. The transportation act, 1920, requires the board to establish wages that are "just and reasonable." It is within the province of the parties herein to make such contentions as they may respectively see fit as to what will constitute a "just and reasonable" wage. If the wage which the motion defines as the "living wage" should be demonstrated to be a "just and reasonable" wage, the board would adopt it; otherwise, it would not. The board will neither limit nor enlarge the right of either party to present to the board his conception of what constitutes a just and reasonable wage within the meaning of the law.

(2) By Mr. Wharton:

The right of all workers, including common laborers, to a living wage is hereby affirmed.

In fixing wages, minimum rates of pay shall be established which will insure the subsistence of the worker and his family in health and reasonable comfort.

The resolution offered by the chairman was adopted by a vote of five to two, seven members present.

The decision of the majority in this case is fundamentally unsound and unacceptable on the same grounds which were set forth in the dissenting opinion of the minority in Decision No. 1028. At that time the views of the minority were developed in great detail, and are applicable to the case under discussion. They may be briefly summarized by the following excerpt from the dissenting opinion to Decision No. 1028:

1. The rates of pay established under this decision as the basic minimum rates of the transportation industry will merely perpetuate the low level of purchasing power possessed by this large class of workers in pre-war years * * * .

2. The rates of pay established under this decision will mean annual earnings far below any minimum standard of subsistence which has been formulated, even below those of most conservative employer groups.

3. The rates of pay established under this decision are not based upon the human needs of the hundreds of thousands of families involved. They are insufficient to provide these families with the absolute essentials. The earnings of this large group of railroad employees will not provide the father of a family with as much food as is allowed convicts in the Cook County (Ill.) jail.

4. The pre-war standard perpetuated by this decision was the product of inequitable wage bargains. It is considerably below the level recognized at that time as necessary for the maintenance of health and energy.

AN INADEQUATE WAGE IS UNJUST AND UNREASONABLE.

The fundamental error of the majority rests upon their refusal to inquire into the adequacy of the rates of pay established for section men and unskilled laborers. Although these rates may be placed on a higher level than those paid by private industries, this does not meet the requirements imposed on the Labor Board by the transportation act, 1920. The specific and fundamental mandate of the law is that wages shall be just and reasonable. The relation of rates of pay to those established in private industry, or the relation of rates of pay to the cost of living, is a *secondary* consideration which does not come into play until the *primary* requirement of a "just and reasonable" or an adequate or living wage has been satisfied. Under these duties of the board it is manifest that the rates of pay of unskilled workers, or those at the bottom of the wage structure, must first be established on an adequate basis—a basis sufficient to maintain and perpetuate in a reasonably comfortable and decent way the unskilled worker and his family—and after this has been done just and reasonable differentials above this basic wage for unskilled labor must be established in accordance with skill, experience, productiveness, hazard, training, etc., or, in other words, in accordance with the seven relevant circumstances specifically mentioned in section 307, as well as others unenumerated but covered by section 301 of the transportation act, 1920.

THE LIVING WAGE IS LEGALLY SOUND.

Under any proper interpretation of the transportation act, therefore, I hold that an adequate or living wage for unskilled

railroad employees is a legal right of such employees, and that the Labor Board is not meeting the mandates imposed upon it by the law in its failure to accept the living-wage principle. The principle should, of course, be applied with discretion and with due caution; nevertheless it is the duty of the board to accept and apply it. No better proof of the propriety of such action can be had than the statements of Senator Albert B. Cummins, chairman of the Senate Committee on Interstate Commerce and one of the authors of the transportation act, 1920. On April 17, 1922, when a hearing was in progress before his committee relative to whether the transportation act, 1920, contemplated the sanction of the living-wage principle to unskilled railway employees, Senator Cummins publicly said:

The CHAIRMAN. My view of it is that here are two men, and one man may agree to work for the other at any wage that he would be willing to accept, whether it is just and reasonable or not, but *when organized society comes to fixing the wage, it is no more right to fix a wage below the point of living and comfortable living than it is to fix a return on capital below a reasonable point.*

WITNESS. That is our contention exactly, Mr. Chairman.

The CHAIRMAN. I think you are right about it.

Senator Cummins' attitude was further elaborated in a statement submitted by the representatives of the employees during the hearings in the present case. In presenting their motion for a ruling on the living-wage principle, in this connection, they said:

Recently, after the shopmen's strike had been in progress about three weeks, or about July 19 last, Senator Cummins was quoted in a newspaper interview as declaring it to be his early intention to sponsor legislation which would empower the Railroad Labor Board to pay a living wage.

"Some way must be found," he said, "to enable the Government to determine what is a 'living wage,' just as the Government is enabled to determine what is a fair return on capital invested. I believe if the Railroad Labor Board had at least attempted to fix a 'living wage' in seeking to reduce the earnings of railroad workers, most of the present difficulty could have been avoided."

(Transcript of proceedings, pp. 127 and 128.)

THE LAW HAS SET ASIDE THE FORCES OF SUPPLY AND DEMAND.

The board must accept some fundamental principle as the basis of wage fixing; otherwise, it can follow no guide but the

relentless, inhuman, fluctuating forces of supply and demand. It can not be denied that in private industries the wages of unorganized and unskilled workers are very largely fixed by these forces. As industrial development progresses, however, supply and demand enters less and less into the wage question, until a condition of affairs is oftentimes reached where employees and employers are organized and are of about equal economic strength, and where both parties agree to meet together and bargain collectively, referring such matters as can not be settled in conference to an impartial tribunal for final adjudication. When this is done, as is the case in many private industries, there can be no place for the invocation of the law of supply and demand. An arbitration board selected must ignore these factors, and in its deliberations and decisions attempt to establish rates of pay which are adequate and equitable, or, in other words, just and reasonable.

Likewise, the transportation act, 1920, under which the Labor Board functions, by establishing a tribunal for determining wages to which all wage controversies must be referred, sets aside the law of supply and demand. It also prohibited the acceptance, as a basis of action by the Labor Board, of the rates in private industries determined by the law of supply and demand. The duty of the board in this respect can not be better expressed than by quoting in part from the decision of the neutral arbitrator in the arbitration case in 1920 of the Eastern Massachusetts Street Railway Co. and its employees. On this point he said:

> So far as my examination of the authorities goes, no employer has before a board of arbitration ever disputed the proposition that the workingman in America is entitled to a minimum fair living wage. * * *
>
> Nor does the company dispute this proposition now. It says that the men are receiving a fair wage, as is proved by the law of supply and demand. I do not believe that the law of supply and demand, however applicable to the purchase and sale of merchandise or to industry in general, should have much, if any, weight in fixing the wage scale in public utilities. The only way in which the applicability of the law can be tested in any case is by the men going on strike and fighting it out to the bitter end. If they are to test it by fighting, then a fair fight requires that they be allowed to strike all at once and use every means legally possible to win their fight. Such a struggle, with its inevitable concomitants of public inconvenience and distress, interruption of business, dislocation of all transportation facilities, and possible disorder, is emphatically not to the public interest, and therefore the whole

economic progress of the last 50 years has been away from the strike as a means of testing whether under the law of supply and demand any wage scale in force is adequate.

The conclusion is irresistible, from the pronouncements of other arbitration tribunals as well as from the statements of Senator Cummins, that "wages in outside industries," or in other words, the supply of and demand for labor, can not be used as a guide for the Labor Board in fixing adequate basic rates for unskilled railroad employees.

The law establishing the Kansas Court of Industrial Relations is framed in similar terms to the transportation act, 1920. The Kansas court is required (secs. 8 and 9 of the law) to establish wages which shall be "reasonable" and "fair." The Court of Industrial Relations has not hesitated to interpret these requirements of the law to mean a living wage to unskilled workers with higher differentials to the more skilled and experienced wage earners. In the case of State of Kansas *v.* Topeka Edison Co., it said:

A living wage may be defined as a wage which enables the worker to supply himself and those absolutely dependent upon him with sufficient food to maintain life and health; with a shelter from the inclemencies of the weather; and with sufficient clothing to preserve the body from cold and to enable persons to mingle among their fellows in such ways as may be necessary in the preservation of life. But it is not a living wage only which this court is commanded by the people of this State to assure workers engaged in these essential industries. The statute uses the word "fair" and commands us to assure to these workers a "fair" wage. What is a "fair" wage? Upon this subject, of course, there may be a great variety of opinions expressed. It seems safe to say, however, that the circumstances above enumerated should be considered in arriving at a conclusion as to what constitutes a fair wage. The skilled worker, in fairness, should have a higher wage than the unskilled worker. The worker who has spent years of time and effort in preparing himself for a peculiarly technical line of work is entitled to greater consideration from the public than the more unskilled worker. The hazards of the employment should also be noted, and the worker engaged in such an employment as that under consideration should receive a higher wage than his fellow worker who may be engaged in a safe occupation. The degree of responsibility placed upon the worker is a matter of importance. The continuity and regularity of employment should be considered, for it is apparent that an employment which is seasonal in its nature must have a higher

wage than one in which regular, steady work is offered, because, after all, it is the annual earnings that are to govern rather than the daily wage in many instances.

THE LIVING-WAGE PRINCIPLE.

The Labor Board should give expression to its acceptance of the living-wage principle and then give it a practical application. This principle has been nowhere better expressed than in the code or series of principles which made up the constitution, so to speak, of the former National War Labor Board. It was as follows:

1. The right of all workers, including common laborers, to a living wage is hereby declared.
2. In fixing wages, minimum rates of pay shall be established which will insure the subsistence of the worker and his family in health and reasonable comfort.

During the period of the war emergency, labor gave up the right to strike. In order that its status might be protected, a national conference of representatives of employers and employees agreed to accept the above principle and a series of others as a guide for the purpose of adjusting wage disputes during the war period. The principles were proclaimed by the President and made mandatory upon industrial relations and conditions. The present chief justice of the United States Supreme Court was a member of the conference which agreed upon the principles to be established, and later, as one of the chairmen of the National War Labor Board, interpreted and practically applied these principles.

THE BUDGETARY METHOD IS NECESSARY AND PRACTICABLE.

The use of a family budget is essential to any attempt at ascertaining practically what a "living wage" should be. Our basic industries do not offer rates of pay which, under normal working conditions, enable an unskilled worker to earn an amount sufficient to support himself and his family in health and modest comfort. His wages must be supplemented by the earnings of his wife and children, or by the taking of boarders and lodgers into the home. Otherwise, the family income is inadequate. The prevailing wage in American industry, in other words, is a family wage. The energies of all the members of the family capable of working are required in order to secure an income sufficient for average needs. That this condition of affairs is also true of the families of maintenance of way employees of the railroads has been demonstrated

by the personal testimony of section men and their wives who have appeared before the Labor Board.

Existing rates of pay in private industries can not, therefore, be used as precedents in determining what a living wage should be. A tribunal such as the Railroad Labor Board in attempting to give practical application to the living-wage principle, can not rely on *what is*, but must find out *what should be.* A budget must be constructed to cover the quantities of foodstuffs and clothing which an average family requires in order to be properly nourished and decently clothed, necessarily housing facilities and fuel, and sundries or miscellaneous articles essential to modest and frugal comfort. When the quantities of the different classes of articles necessary to the healthful consumption of an average family have been determined, the different articles can then be priced, and the sum of these prices indicates what annual income should be had. If the aggregate cost of the articles required to maintain a conservative standard of healthful and decent living is then divided for a given period by the normal working time, the average rate per hour or day may be ascertained which should be paid to the average unskilled worker in order that he may support his family in reasonable health and comfort. It is not claimed, of course, that a living wage rate can thus be determined with mathematical precision, but the approximate amount which is necessary to support an average workingman's family in health and decency can be found out, and on this basis the board could proceed conservatively and with due discretion to fix a rate of pay which would be reasonably adequate.

The practicability of the budgetary method has already been demonstrated by experience. It has been used in many states by wage boards and commissions to establish minimum rates of pay for women in mercantile and manufacturing establishments. It has also been adopted by the former National War Labor Board, the Kansas Court of Industrial Relations, and by the Commonwealth and other arbitration boards in Australia.

Many objections, both from the standpoint of equity and of a practical statistical character, have been submitted against the budgetary method by the representatives of the railroads. Some of these objections are merely technical; others involve more serious considerations. None are insurmountable, and all can be overcome by the exercise of sound judgment and discretion by the board.

It has also been claimed that the practical application of the living wage principle by the budgetary method would be financially impossible, or would involve such a financial outlay as would constitute a grievous burden to the shipper and to the consumer. If established on the railroads, it is also declared that it would have to be met by private industries, and the resultant cost would mean a general increase in prices or an industrial breakdown.

Similar arguments and prophecies have been developed in the past against the establishment of the eight-hour work day and other measures of industrial equity or amelioration. The dire results which have been predicted have never materialized. Likewise, a conservative, practical application of the living-wage principle would undoubtedly be attended by better and more advantageous conditions of railway operations. Added labor costs would be absorbed completely or to a large extent by increased labor efficiency and by managerial ability. The practical experience in Australia where this same argument was used against the adoption of the living-wage principle as the basis for wage-fixing is of much value, and shows the unsoundness of the position of those who have taken an attitude of extreme opposition. That this experience in that country has been most favorable is indicated by the following quotations from opinions of the president of the Industrial Court of South Australia:

> The president is bound by law to award not less than a living wage. If that wage is higher than has been previously fixed, the excess may come out of the profits of the employer. But if it should so happen that the excess can not be paid out of profits there are other sources to be drawn on. There is the possibility of increased economy or increased efficiency in the conduct of the business concerned. There is the possibility that an increased output on the part of employees may enable the employers to avoid shutting down. A great deal of evidence might be adduced to show that in Australia the sources to which I have referred as available for paying higher wages—increased economy or efficiency of business organizations and an increased output on the part of the worker—are sources from which, under the stimulus of necessity, much more might be drawn than at present. I do not speak of all industries, but my remark is fairly applicable to a large number * * * I dwell upon these things because I wish to show that if this court, in declaring a living wage, declares a wage which apparently can not be paid by the industry concerned, the court is not necessarily shutting down the industry. In a number of cases which have come before Australian industrial tribunals, the argument has been brought forward that a particular business or in-

dustry would have to be closed down if the wages were raised, and yet the industry or business has continued despite increased wages, and is to-day paying reasonable dividends. Whether the result be due to the potential economy of high wages, or to the fact that employers have discovered that necessity is the mother of invention, or to other circumstances, I need not pause to consider. The fact is indisputable.

Nor is it sound business to underpay the worker. It is true that particular employers may make *profits* by the award of a wage lower than the true living wage. But *the interests of the employers as a whole* are not to be promoted by sweating wages, or even by a bare subsistence wage. * * * I can not too strongly emphasize the fact that it is for the interests of the employers themselves, as well as for the employees, that the living wage awarded by this court should be such as to insure to every workman a wage sufficient to maintain him in a high state of industrial efficiency, and to provide his family with the necessaries for health and well-being. When economists speak of the *potential economy of high wages*, they are not talking in the air. They are talking of something which has been demonstrated in the industrial development of modern communities.

The mistake that is often made by private employers is the mistake so commonly, and I fear justly, attributed to Governments—the mistake of *seeking efficiency through economies rather than economy through efficiency*.

Sound national economy embraces the recognition of the need for securing such a return for work, whether mental or physical, as will maintain the worker in health and efficiency and stimulate his or her ambition. The realization of the fact, in its bearing upon maximum production at lowest cost of production, leads to the conclusion that lowest cost of production should be sought for less in low rates of wages than in increased skill in the management, and in increased efficiency of the worker.

It may be conceded that an increase in the price of a commodity produced has sometimes been inevitable where wages have been increased. But I do not hesitate to express the opinion that, in a majority of cases, the increase of prices, aside from fluctuations in the world's markets, and omitting for the moment the possibility of some diversion of profits to wages, might have been avoided by a greater efficiency on the part of employers and employees by eliminating, as far as possible, the waste of disorganized industry by the installation of up-to-date plants, and the adoption of the most effective methods of business organization. (South Australian Industrial Reports, vol. 2, 1918–19, pp. 3–4, 45–46, 80–81, and 235.)

The experience of Australia in establishing adequate basic wages without industrial dislocation is also further corroborated by the experience of Great Britain under the trade boards act of

1909, and of the various states in this country which have established minimum wages for women engaged in trade and industry.

As a matter of fact, there is no sound reason why the budgetary method can not be employed to determine what the minimum income essential to the reasonable living requirements of an unskilled laborer, wife, and three dependent children should be; furthermore, there is no sound reason why such a standard can not be ascertained and applied to the transportation industry without impairment of its economical and efficient operation. Under a proper application, it would undoubtedly reduce, rather than increase, labor costs. The only criticism, indeed, which has been made has not been against the budgetary method but against its application. It has been twofold:

(1) The standard of living which should be allowed as the basis of a living wage; and (2) the size of the family unit. But the request of the employees in this case for a recognition of the living-wage principle, and its application to the extent only of an opportunity for laborers and section men to earn a maximum of $1,175 a year, has been so reasonable, conservative, and so financially practicable that it has seemed to me that it should have been granted by the Labor Board pending a more exhaustive inquiry as to what a living wage should actually be. The requests of the employees, in other words, have impressed me not only as being reasonable and conservative, but clearly within the range of practical application.

NEGRO AND MEXICAN LABOR AWARDED FAVORABLE WAGES.

Reference is made by the majority to rates of pay established for section men and common labor by certain carriers in the Southeast and that these rates are below the minimum of 25 cents per hour established by this decision, but nothing is said to indicate how these rates were put into effect. It is my information that a committee composed of section foremen conducted these negotiations, and that the negro laborers whom they assumed to represent and for whom they agreed to accept these reductions had no proper opportunity of expressing their wishes. It is significant that the section foremen on the same roads quite generally received increases in their rates of pay. The Labor Board had information as to the rates of pay established by certain of the southeastern roads prior to the issuance of its Decision No. 1028, and none of these roads were, so far as this class of employees are

concerned, parties to the dispute resulting in the issuance of Decision No. 1028. . . .

The minimum rate of 25 cents an hour established by this decision represents an annual full-time wage of $612 or $51 per month. This is the definition of a just and reasonable wage as decided by the majority of the board. The majority state:

> As a matter of fact, this 25-cent minimum is a higher wage than the 37-cent minimum, when considered in relation to the living conditions of the respective territories.

As this rate applies in the territory where negro and Mexican labor predominate, then it is a fair assumption to say that the majority has established a more favorable standard of living for these nationalities than for others.

We ask that you visualize a typical family and habitation of a negro laborer in any of the Southeastern or Southern States, and judge whether or not a decision that establishes a standard of living on that basis is justifiable in the eyes of God or man.

EFFECT OF WAGE REDUCTIONS ON COUNTRY.

Mr. William Randolph Hearst recently published an article which I herewith reproduce:

> The great injury inflicted upon the business of the country by the coal and railroad complications and upon the people of the country and upon the Nation itself, is due primarily to the fundamental economic error that wages should be reduced and that any benefit can come to a country by reduction of wages.
>
> If the late great war has anything at all to its credit, anything at all that we can look to as a general advantage to humanity, it is the fact that the war and the conditions which it created tended to raise the wage scale.
>
> The effort of all intelligent people, as well as humanitarian people, the effort of all people familiar with social and economic principles and objectives should have been to maintain this wage scale and the standard of living made possible by a high wage scale, even though the cost of living should be somewhat reduced.
>
> We know perfectly well that the supremacy of American products is not due and never has been due and never will be due to the *cheapness* of American labor.
>
> It is due to the skill of American labor, the intelligence and education of American labor, the contentment, energy, and enthusiasm of American labor, and, of course, in addition to this superiority of American labor, the superiority of American machinery.

The superior skill, education, contentment, energy, enthusiasm of American labor are due primarily to the superior American standard of living and the opportunities, ambitions, and interest which that high standard of living creates.

To strike at that standard of living of the American laborer is to strike at the very base of all his superiority, to kill his superior skill and intelligence, his contentment, enthusiasm, and interest at the very root.

It is the extreme of false economy; it is the utmost of bad management—to say nothing of the social and ethical questions involved.

It may be taken as an elemental proposition that no saving from wage reduction compensates for the loss of production from discontented labor, or labor rendered less efficient through a reduction of the standard of living and a consequent limitation of those opportunities for education and individual improvement which make American labor the most efficient in the world.

In addition to the injury which a reduction of wages inflicts upon labor and through labor upon production, there is the general injury upon all business which a reduction in purchasing power of the mass of the community inevitably involves.

It is possible that we business men do not realize that a great part of the general prosperity of the war period and the immediate post-war period was due to high wages and the general distribution of those wages in purchases—for the workingman generally spends nearly all that he earns.

When wages were high the workingman and his family bought freely, the shops prospered, store stocks were exhausted, the factories were overwhelmed with orders, and the fullest market prevailed for raw material furnished by the farm and the mine.

Do you, fellow business man, who owns a store, fail to realize that the hand which reduces wages dips into your till to deprive you of a proportionate part of your patronage and your profits?

Do you, fellow business man, who runs a factory, fail to realize that your orders come from those shops, and are dependent in turn upon the patronage and prosperity of those shops?

Do you, fellow farmers and fellow miners, fail to realize that the demand for your products depends upon the demands from the factories, and that these factories depend upon the orders from the shops, and the orders from the shops depend upon the prosperity and the patronage of those shops, which are in turn dependent upon the prosperity of the wage earners, the greatest individual element in the whole nation?

The conditions of prosperity are a very economic "house that Jack built," and the foundation of the house is the welfare of the worker, based on good wages and consequent high purchasing power.

Therefore when the mine owners and railroad owners demanded a reduction of wages without absolute necessity they committed

a fundamental economic error. When the Railroad Board authorized a reduction, they sanctioned a blow not only at the welfare of the workers, but at the general welfare of all business and at the prosperity of the country.

Of course, the workers would not tolerate this reduction in wages wholly unnecessary and unjustifiable at this time; and, whether moved by selfish consideration or not, they were performing a patriotic service in not tolerating it.

The plain truth of the matter is that any management of any business which can not succeed, and still pay good wages is not only inefficient but un-American, because good wages for good work not only is but is recognized to be a fundamental American proposition.

Most of our American business men are able to conduct their businesses successfully and pay high wages; and they conduct their businesses successfully not in spite of the high wages but on account of the high wages, because success is a combination of efficient management and efficient labor.

The proof that reduction in wages was in no way necessary at this time in the coal mines and on the railroads is shown in the fact that great industries like the Steel Trust, under the skillful management of Elbert H. Gary, were raising their wages 20 per cent at the time these mining and railroad industries were attempting to reduce wages and is further shown in the fact that the coal operators have finally put their men back to work at the old wage, and can, and will, not only conduct their business successfully with wages at that standard but profiteer very handsomely in addition.

The railroads must not only eventually pay the previously established wage, which they attempted to reduce, but will probably soon have to pay an added wage.

The demand for labor is increasing throughout the nation. Wages will increase in proportion and the opportunity to take advantage of the necessities of the workingman will not exist, even for those who shortsightedly desire to take such advantage.

The fundamental mistake, therefore, which has precipitated all the injury of these strikes and these interruptions of the business of the country and these burdens upon business and upon individual citizens, which will endure as long as the limitations on fuel and transportation endure, was made by the coal operators and the railroad managers when they unjustifiably demanded lower wages, and by the Railroad Labor Board which sanctioned these unjustifiable demands.

Perhaps these mistakes may not be made so often when it is thoroughly realized how important high wages and a high standard of living and a high purchasing power are not only to the general prosperity of the nation but to the prosperity of every individual business, to my business and to your business and to every business and profession and occupation throughout the whole country.

A. O. WHARTON.

STATEMENT.

For the reasons set out in the decision, I believe that an increase for employees in maintenance of way service is justified, but I do not feel that the increase contemplated by this decision is sufficient. However, I felt obliged to vote for the proposition when it appeared that the long delay in reaching a decision was working to the detriment of the men affected. The Labor Board took up the question of establishing just and reasonable wages for this class of employees on October 2, 1922, and after a period of 19 days no decision had been reached.

The increase of 2 cents per hour is equivalent to nearly $23,000,000 per annum, or approximately $70,000 a day. This delay in the board's action therefore meant a loss to the employees of about $1,000,000 in earnings, and failure to reach a decision would not only have further augmented this loss in earnings, but might have resulted in this class of employees receiving no increase.

W. L. McMenimen.

SUPPORTING OPINION.

The fundamental difference between the decision herein and the dissenting opinion is that the former is based upon the transportation act, 1920, and the latter upon a fantastic theory, the very essence of which its own proponents expressly characterized in the hearing before the Labor Board as a "guess and a makeshift."

The theory of the dissenting opinion, if carried to its legitimate conclusion, would wreck every railroad in the United States and, if extended to other industries, would carry them into communistic ruin.

The law directs the Labor Board to establish "just and reasonable" wages for this class of railway employees, and it sets out seven factors or elements which the board shall consider, among other relevant circumstances, in reaching a conclusion as to what is a just and reasonable wage.

The factors so named in the statute are as follows:

(1) The scales of wages paid for similar kinds of work in other industries;
(2) The relation between wages and the cost of living;
(3) The hazards of the employment;
(4) The training and skill required;
(5) The degree of responsibility;

(6) The character and regularity of the employment; and
(7) Inequalities of increases in wages or of treatment, the result of previous wage orders or adjustments.

The board is impressed with the idea that Congress has thus enumerated the considerations which any intelligent business man of just social conceptions would naturally adopt in fixing a just and reasonable wage.

It is the view of the majority that it is its duty to give due weight to all seven of these factors, but the dissenting opinion summarily excludes the first and argues that it should receive no consideration.

The contention of the expert economists in their presentation of this case for the employees was that the board should fix for common labor "the living wage." This is likewise the basis of the dissenting opinion.

If the contentions were that the board should establish "a living wage," the majority would readily accede to the proposition, and, as a matter of fact, the board in this instance, as in all others, has granted a living wage.

But the abstract, elusive thing called "the living wage," confessedly based upon a makeshift and a guess, can not receive the sanction of the board, because it would be utterly impractical and would not be "just and reasonable" as the law commands. The living wage is defined by its proponents before this board as follows:

A wage which will support a family of five in health and reasonable comfort, such family being assumed to consist of a husband and wife and three dependent children under 16 years of age.

This constitutes a bit of mellifluous phraseology, well calculated to deceive the unthinking. It has frequently been demonstrated that a melodious slogan contains more possibilities of danger and destruction than a dynamite bomb.

To ascertain what is reasonable comfort, it is proposed that experts shall prescribe a standard of living for a family of five, setting out in minute detail what the experts think such a family should have in food, clothing, furniture, housing, and all the other necessaries of life. The fallacy of this proposal is inherent and fundamental. That it would be wise and practical to undertake to establish an arbitrary standard of living for several millions of people is not apparent. That the desires and requirements of all men are equal and alike is not correct, and that any committee

of experts could set up an average living standard upon which a wage scale could be practically based has not been demonstrated anywhere. If theorists should evolve such a standard of living, it would not be possible to obtain any general conformance to it by those for whom it was designed. Standards of living have never been theorized into men. A man can not be picked up by the scruff of the neck and hoisted into a new standard of living. Such a change in the individual man is a matter of growth and development. When brought about by natural processes, it is socially and economically beneficial, but, if attempted by legislation, it is a wasteful absurdity. To provide a somewhat expensive standard of living for a man who by habits, training, and ambition is not prepared for it, wastes money and confers no real benefit on the individual.

It may well be observed that this theory of standardization necessarily fails to take into account many of the economies that are practiced by thrifty people who desire to get ahead in the game of life.

That standards of living are gradually improving in this country is undoubtedly true, and this is as it should be. There is no member of the Labor Board who does not profoundly desire improved living conditions for common labor, but it is our belief that this movement must be continued along the lines indicated by human experience and that it can not be consummated in the twinkling of an eye by artificial expedients.

As a matter of fact the expert representative of the employees in this case admitted that the immediate establishment of "the living wage" would, to adopt his language, "throw a monkey wrench into the industrial machinery." He therefore suggested that the board only make a start in that direction at this time. Such a proposition is entirely illogical. If the living wage is the just and reasonable wage authorized by the statute, it is the duty of the Labor Board to establish it now. If it is not the just and reasonable wage commanded by the law, then it is not the duty of the board to adopt it now or hereafter, unless the law be changed.

If it would now be equivalent to a monkey wrench thrown into the machinery, as its advocate says, it might amount to the same thing later on, and the Railroad Labor Board made no mistake in declining to commit itself to this theory.

The adoption of the family of five as the typical family is arbitrary and questionable. According to the United States census

of 1920 there were 24,351,676 families in a population of 105,710,620, an average of 4.4 persons to a family, and not 5. This includes all members, regardless of age. The census also shows that there were about 35,000,000 dependent children under 16 years of age, an average of 1.4 dependent children to a family, and not 3, as assumed in the living-wage theory.

Furthermore, the 1920 census also shows that for each family there are 1.36 male workers. According to the living-wage theory, each family of five would be supported by one worker, while, as a matter of fact, each family would have the support of 1.36 workers.

It is interesting and instructive to take note of the undoubted results that would follow the adoption of the theory of "the living wage." The representative of the employees states that according to the lowest living budget now available the living wage for common labor should be 72 to 75 cents an hour.

To bring the rates of common labor on the railroads to 72 cents an hour would necessitate an increase of 125.7 per cent. To maintain existing differentials between the rates of common labor and skilled labor—and the representatives of the employees insist that proper differentials must be maintained—would necessitate an increase by the same percentage of the rates of all classes of railroad workers.

This would add approximately $3,112,952,387 to the annual pay roll, bringing it up to $5,589,445,993. Total expenses would then be approximately $7,804,871,733, and total revenues (1921) $5,563,232,215, and the carriers would face an annual deficit of $2,241,639,518.

But, the representatives of the employees say, it would be impracticable to establish the living wage all at once, but that as a starter 48 cents an hour should be made the minimum wage for common labor for the present. Assuming the retention of the existing differentials for common labor on the railways and for all other classes of labor, this would mean an increase of 50.45 per cent, which would add to the annual wage bill $1,249,390,994, bringing it up to $3,725,884,540.

The total annual expenses of the railways would be $5,941,310,340 and total revenues (1921) $5,563,232,215, and the carriers would be up against an annual deficit of $378,078,125.

In either instance there would not be a cent of returns for stockholders. Of course, for those who desire Government ownership this would be a quick method of getting it, for it is a sure thing that

the public would not stand for the imposition of higher rates to pay such a deficit.

It must be remembered, in the last analysis of the matter, that the public would have to pay this wage bill, and when we say the public, everybody, rich and poor, is included. A vast percentage of the burden would be passed on to laboring men and women in other lines of industry in the form of increased living expenses. From the effort to meet such increased expenses there would necessarily result a wide extension of the struggle to raise wages in all other lines of industry, and the disturbance and disorganization of business in general.

It is our belief that the people of this country are perfectly willing that railway labor, with its hazard, skill, and responsibility, should be well compensated, even to the point of liberality. In view of this friendly public sentiment, it is not wise for labor organizations to seek to impose upon the farmers and producers of the country a crushing burden at a time when the losses of readjustment are so keenly remembered.

The argument that this theory of the living wage has been successfully tried out in Australia is not sustained by the record in this case, nor by the general information accessible to the Labor Board. Most of the evidence on this point is out of date. It is admitted by the representative of the employees that Premier Hughes, of Australia, rejected the living-wage recommendation of the commission, reporting it as an impossible burden to industry.

Neither is it believed that the Australian countries can be pointed to as examples of industrial prosperity and happiness. Men are prone to believe that ideal conditions exist in distant lands, and we have even heard Soviet Russia extolled as the land of superlative prosperity for labor. Those who have been privileged to view conditions in such countries at short range have usually returned to the United States quite convinced that it is better to strive for the improvement of what we have than to supplant it by the visionary experiments of wild-eyed agitators.

The lengthy newspaper article of William R. Hearst incorporated in the dissenting opinion is not evidence in this case. Mr. Hearst was not sworn nor cross-examined, nor is it shown that he is an expert on questions of the sort here involved. In so far as the article in question is adopted as the views of the signer of the dissenting opinion, it is pertinent and important, but a discussion of its many fallacies and misstatements need not now be entered upon in detail.

It is worthy of note, however, that this article thus approvingly quoted contains the statement that the unjustifiable lowering of the shopmen's wages caused the strike. Such a statement adopted and indorsed in an official document by a member of this board deserves, at least, brief comment.

In the judgment of a majority of the Labor Board, and, we believe, of a great majority of the people, the shopmen's strike [1] was an egregious blunder without any real justification, and this is said with the kindliest feeling for the employees who have suffered most from its effects. It has wrought harm to all and good to none. It has burdened the railways with an unjust expense, has inflicted great losses upon the public, especially the food producers, and has resulted in approximately $177,535,524 loss to the strikers. For all this, the men on strike have won nothing. They have gained no concession as to any matter upon which they struck. For months the strike has been merely a struggle upon the part of the men to regain their positions. In vivid contrast stands the course of the maintenance of way employees, whose officials wisely prevented a strike. Since July 1 this class of employees has received wages approximately $147,656,866, which would have been lost on strike, and now, by orderly and legal processes, they are receiving under the present decision an increase in wages approximating $20,000,000 per year.

Perhaps there is no better time and place to emphasize the belief of a majority of the Labor Board that railway strikes are utterly useless and wasteful, and that the employees will always gain better results at the hands of any tribunals fairly constituted and representative of the people than they will by making war on the carriers and the public.

The most disturbing influence prevalent in railway operation today is the continuous preachment that the laboring man can not trust the courts and tribunals of his country, and must therefore resort to force for the attainment of justice.

Nothing here said should be construed as an effort to discourage the legitimate activities of organized labor. It serves an essential purpose in the body politic. The conduct of the maintenance of way organization in connection with this wage controversy exemplifies the exalted service that may be rendered to labor and to our Republic by statesmanlike leadership of the railway employees.

[1] See pp. 730–774.—Ed.

CHAPTER XXVI

RULES AND WORKING CONDITIONS

1. National Agreements: Railroad Labor Board Decision No. 119 [1]

This decision determines the undecided portion of the dispute between the carriers and organizations of their employees referred to the Labor Board, April 16, 1920. That dispute was what should constitute reasonable wages and working conditions on the carriers parties thereto. On July 20, 1920, this Board decided the wage portion. It now decides upon a method of arriving at rules regulating working conditions.

The parties are set forth in Exhibit A.

From December 28, 1917, to March 1, 1920, the President took over and operated through the Director General of Railroads the carriers parties to this dispute. On March 1, pursuant to the Transportation Act, 1920, these carriers reverted to their owners.

During Federal control the Director General of Railroads entered into contracts with organizations of employees of these carriers. These contracts, called national agreements, set out the classes of employees affected, define with particularity the grades in each class, specify work to be done by each grade, hours of service, when payments shall be made, how forces shall be reduced, seniority determined, work assigned, grievances adjusted, apprentices trained, and otherwise fix the rights and obligations of the parties as to working conditions. These agreements by their terms expired with Federal control. In the same period certain orders, supplements thereto and interpretations thereof, relating to wages and working conditions of railroad employees, were issued by the authority of the Director General. These orders, etc., among other things, classified positions, determined the duties and rights of the incumbents, and fixed the wages to be paid such incumbents. These orders and supplements provided that they should be incor-

[1] *International Association of Machinists et al.* v. *Atchison, Topeka and Santa Fe Railway et al.*, Decisions of United States Railroad Labor Board, vol. 2, p. 87 (April 14, 1921). See Vanderblue and Burgess, pp. 373–376, 383–387, and Jones, pp. 471–472, 572–575.

porated into existing agreements between railroads and their employees.

In February, 1920, the said organizations pressed long-standing requests for wage increases on the Director General of Railroads, who declined to act, as Federal control was almost at an end. On February 28, the Transportation Act became law. Section 301 provides that all disputes between carriers and their employees shall be considered and, if possible, decided in conference between representatives of the parties, and if there undecided, shall be referred for decision to the Railroad Labor Board created by the act. Accordingly, the Association of Railway Executives appointed representatives of the carriers released from Federal control to confer with representatives of the organizations on the pending requests for wage increases.

The representatives met in Washington on March 10, 1920. On March 24, the employees requested that the carriers' representatives secure authority to enter into an agreement preserving after September 1, 1920, the provisions of the general orders, supplements, and addenda issued by the United States Railroad Administration as well as the national agreements and interpretations thereof. On March 30, the representatives of the carriers declined to request such authority.

No agreement was reached by the conference on any matter in dispute, and on April 16 the entire dispute was referred to the Labor Board.

On May 3, 1920, the organizations were informed by the chairman of the Association of Railway Executives that the association had taken the following action on the request for continuance of the national agreements, orders, etc., of the Railroad Administration:

> That the matter of continuing national agreements, interpretations thereof and general orders and all other arrangements negotiated between the United States Railroad Administration, and the so-called standard recognized labor organizations shall be handled by negotiation between the management and employees of each individual railway.

It was further stated that "this recommendation" had been conveyed to all the member roads of the association.

Accordingly, the organizations arranged for the presentation about May 1, 1920, to each carrier of a request for the continuance of the national agreements, etc. Such requests were thereafter

made on each carrier. Conferences on the requests were denied by the officers of the carriers in general on the ground that the matter had been referred to the Labor Board for decision.

In formulating Decision No. 2, the Labor Board perceived that to inquire into the justness and reasonableness of the national agreements, etc., as well as to decide what shall constitute just and reasonable wages, was impracticable. Time for such inquiry was lacking. Accordingly, at that time the matter of the national agreements and of the orders, etc., of the United States Railroad Administration was thus disposed of:

> There are in the dispute as presented questions involving rules and working conditions, some of which are interwoven with and materially affect earnings and wages. Adequate investigation and consideration of these questions would demand time. Existing conditions required that the Board should make as early decision of the wage question as practicable. For that reason, it has been necessary—and both parties to the controversy have indicated it to be their judgment and wish—that the Board should separate the questions involving rules and working conditions from the wage question. Accordingly, the Board has not undertaken herein to consider or change the rules and agreements now existing or in force by the authority of the United States Railroad Administration or otherwise and this decision will be so understood and applied.
>
> The Board assumes as the basis of this decision the continuance in full force and effect of the rules, working conditions, and agreements in force under the authority of the United States Railroad Administration. Pending the presentation, consideration, and determination of the questions pertaining to the continuation or modification of such rules, conditions, and agreements no changes therein shall be made except by agreement between the carrier and employees concerned. As to all the questions with reference to the continuation or modification of such rules, working conditions, and agreements, further hearings will be had at the earliest practicable date and decision thereon will be rendered as soon as adequate consideration can be given.

On December 18, 1920, the parties were notified to present, beginning January 10, 1921, evidence and argument on this dispute.

The evidence and arguments submitted support the following conclusions:

The duty imposed by section 301 on all carriers and their officers, employees, and agents to consider and if possible to decide in conference all disputes between carriers and their employees has not

been performed by the parties hereto either with regard to the wage or the working conditions portion of this dispute. The record shows that the representatives of the carriers were unwilling to assume the responsibility of agreeing to substantial wage increases. Hence, the conference of March 10 to April 1, 1920, on the side of the carriers was merely a perfunctory performance of the statute. Nor was the action of the organizations with regard to the individual carriers more than perfunctory. Naked presentation as irreducible demands of elaborate wage scales carrying substantial increases, or of voluminous forms of contract regulating working conditions, with instructions to sign on the dotted line, is not a performance of the obligation to decide disputes in conference if possible. The statute requires an honest effort by the parties to decide in conference. If they cannot decide all matters in dispute in conference, it is their duty to there decide all that is possible and refer only the portion impossible of decision to this Board.

Although section 301 has not been complied with by the parties, the Board has jurisdiction of this dispute, as it is and has been one likely substantially to interrupt commerce.

The carriers parties hereto maintain that the direction of this Board in Decision No. 2, extending the national agreements, orders, etc., of the Railroad Administration as a *modus vivendi* should be terminated at once; and that the matter should be remanded to the individual carriers and their employees for negotiation and individual agreement.

The organizations maintain that the national agreements, orders, etc., with certain modifications desired by the employees should be held by this Board to constitute just and reasonable rules; and should be applied to all carriers parties to the dispute, except to the extent that any carrier may have entered into other agreements with its employees. They maintain that local conferences requiring necessarily the participation of thousands of railroad employees for several weeks would constitute an economic waste and would produce a multiplicity of controversies as well as irritation and disturbance. They also urge that to require local conferences would be to expose the local organizations on the several carriers to the entire power and weight of all the carriers acting through the Association of Railway Executives on the conferring carrier; that such a disparity of force would produce an inequitable result highly provocative of discontent and likely to result in

traffic interruptions. They, accordingly, insist that the conference should be national.

The carriers maintain that rules negotiated by the employees and officers who must live under them are most satisfactory; that the participants in such negotiations know the intent of the rules agreed to and advise their fellow workmen and officers accordingly, thereby avoiding a litigious attitude on both sides; that substantial differences exist as between the several carriers with relation to the demands of the service, necessary division of labor, and other factors, which differences should be reflected in the rules; that these local differences can be given proper consideration only by local conferences. The carriers refuse to confer nationally.

The Labor Board is of the opinion that there is merit in the contentions of each party, and has endeavored to take action which will secure some of the advantages of both courses.

This Board is unable to find that all rules embodied in the national agreements, orders, etc., of the Railroad Administration constitute just and reasonable rules for all carriers parties to the dispute. It must therefore, refuse the indefinite extension of the national agreements, orders, etc., on all such carriers as urged by the employees.

This Board also deems it inadvisable to terminate at once its direction of Decision No. 2 and to remand the dispute to the individual carriers and their employees. Such a course would leave many carriers and their employees without any rules regulating working conditions.

If the Labor Board should remand the dispute to the individual carriers and their employees and should keep the direction of Decision No. 2 in effect until agreements should be arrived at, it is possible that agreements might not be arrived at.

The Labor Board believes, nevertheless, that certain subject matters now regulated by rules of the national agreements, orders, etc., are local in nature and require consideration of local conditions. It also believes that other subject matters now so regulated are general in character and that substantial uniformity in rules regulating such subject matters is desirable.

The Board also believes that certain rules are unduly burdensome to the carriers and should in justice be modified. It may well be that other rules should be modified in the interest of employees.

To secure the performance of the obligation to confer on this dispute, imposed by law on officers and employees of carriers, to

bring about the recognition in rules of differences between carriers where substantial, to preserve a degree of uniformity in rules regulating subject matters of a general nature, to prevent to some extent the operation in negotiations of a possible disparity of power as between the carriers and their employees, and to enable the representatives of employees of each carrier and the officers of that carrier to participate in the formulation of rules under which they must live, the Labor Board has determined upon the following action:

Decision.—1. The direction of the Labor Board in Decision No. 2, extending the rules, working conditions, and agreements in force under the authority of the United States Railroad Administration, will cease and terminate July 1, 1921.

2. The Labor Board calls upon the officers and system organizations of employees of each carrier, parties hereto, to designate and authorize representatives to confer and to decide so much of this dispute relating to rules and working conditions as it may be possible for them to decide. Such conferences shall begin at the earliest possible date. Such conferences will keep the Labor Board informed of final agreements and disagreements to the end that this Board may know prior to July 1, 1921, what portion of the dispute has been decided. The Labor Board reserves the right to terminate its direction of Decision No. 2 at an earlier date than July 1 with regard to any class of employees of any carrier if it shall have reason to believe that such class of employees is unduly delaying the progress of the negotiations. The Board also reserves the right to stay the termination of the said direction to a date beyond July 1, 1921, if it shall have reason to believe that any carrier is unduly delaying the progress of the negotiations. Rules agreed to by such conferences should be consistent with the principles set forth in Exhibit B, hereto attached.

3. The Labor Board will promulgate such rules as it determines just and reasonable as soon after July 1, 1921, as is reasonably possible and will make them effective as of July 1, 1921, and applicable to those classes of employees of carriers parties hereto for whom rules have not been arrived at by agreement.

4. The hearings in this dispute will necessarily proceed in order that the Labor Board may be in position to decide with reasonable promptness rules which it may be necessary to promulgate under section 3 above.

5. Agreements entered into since March 1, 1920, by any carrier

and representatives of its employees shall not be affected by this decision. . . .

Exhibit B.

Exhibit Referred to in Decision No. 119.

PRINCIPLES.

1. An obligation rests upon management, upon each organization of employees, and upon each employee to render honest, efficient, and economical service to the carrier serving the public.

2. The spirit of cooperation between management and employees being essential to efficient operation, both parties will so conduct themselves as to promote this spirit.

3. Management having the responsibility for safe, efficient, and economical operation, the rules will not be subversive of necessary discipline.

4. The right of railway employees to organize for lawful objects shall not be denied, interfered with, or obstructed.

5. The right of such lawful organization to act toward lawful objects through representatives of its own choice, whether employees of a particular carrier or otherwise, shall be agreed to by management.

6. No discrimination shall be practiced by management as between members and nonmembers of organizations or as between members of different organizations, nor shall members of organizations discriminate against nonmembers or use other methods than lawful persuasion to secure their membership. Espionage by carriers on the legitimate activities of labor organizations or by labor organizations on the legitimate activities of carriers should not be practiced.

7. The right of employees to be consulted prior to a decision of management adversely affecting their wages or working conditions shall be agreed to by management. This right of participation shall be deemed adequately complied with if and when the representatives of a majority of the employees of each of the several classes directly affected shall have conferred with the management.

8. No employee should be disciplined without a fair hearing by a designated officer of the carrier. Suspension in proper cases pending a hearing, which shall be prompt, shall not be deemed a violation of this principle. At a reasonable time prior to the hearing he is entitled to be apprised of the precise charge against him. He shall have reasonable opportunity to secure the presence of necessary witnesses and shall have the right to be there represented by a counsel of his choosing. If the judgment shall be in his favor, he shall be compensated for the wage loss, if any, suffered by him.

9. Proper classification of employees and a reasonable definition of the work to be done by each class for which just and reasonable

wages are to be paid is necessary, but shall not unduly impose uneconomical conditions upon the carriers.

10. Regularity of hours or days during which the employee is to serve or hold himself in readiness to serve is desirable.

11. The principle of seniority long applied to the railroad service is sound and should be adhered to. It should be so applied as not to cause undue impairment of the service.

12. The board approves the principle of the eight-hour day, but believes it should be limited to work requiring practically continuous application during eight hours. For eight hours' pay eight hours' work should be performed by all railroad employees except engine and train service employees, regulated by the Adamson Act, who are paid generally on a mileage basis as well as on an hourly basis.

13. The health and safety of employees should be reasonably protected.

14. The carriers and the several crafts and classes of railroad employees have a substantial interest in the competency of apprentices or persons under training. Opportunity to learn any craft or occupation shall not be unduly restricted.

15. The majority of any craft or class of employees shall have the right to determine what organization shall represent members of such craft or class. Such organization shall have the right to make an agreement which shall apply to all employees in such craft or class. No such agreement shall infringe, however, upon the right of employees not members of the organization representing the majority to present grievances either in person or by representatives of their own choice.

16. Employees called or required to report for work, and reporting but not used, should be paid reasonable compensation therefor.

2. Contracting of Repairs: Railroad Labor Board Decision No. 982[1]

Question.—Are the contracts which the Indiana Harbor Belt Railroad Co. has let for the operation of its railway shops in violation of the transportation act, 1920, and of the wage and rule decisions of the Railroad Labor Board, and do said contracts remove from under the jurisdiction of the Railroad Labor Board the employees who, under said contractor, are performing shop work for the carrier?

Statement of facts—History of contracts.—The stock of the Indiana Harbor Belt Railroad Co. is owned by four carriers, as

[1] *Railways Employees' Department, A. F. of L. (Federated Shop Crafts)*, v. *Indiana Harbor Belt Railroad Company*, Decisions of United States Railroad Labor Board, vol. 3, p. 332 (May 9, 1922). See Vanderblue and Burgess, pp. 388–390, and Jones, p. 581.

follows: New York Central Railroad Co., 30 per cent; Michigan Central Railroad Co., 30 per cent; Chicago, Milwaukee & St. Paul Railway Co., 20 per cent; and Chicago & North Western Railway Co., 20 per cent.

January 1, 1921, the carrier posted a notice that its car-repair shop at Burnham would be shut down January 19, 1921, and on January 17, 1921, the carrier posted another notice, stating that the Burnham Car Repair Co. would take charge of the work at that point. The parties entered into a contract January 29, 1921, covering the carrier's car-repair work at Burnham and West Hammond.

July 1, 1921, the parties entered into a new contract for Burnham and West Hammond, identical with the first, except that the percentage for compensation of contractor was reduced from 12 per cent to 5 per cent.

On January 19, 17 men were laid off by the carrier.

About January 20, 1921, the Burnham Car Repair Co. took over the car-repair work of the carrier at its rip track at Calumet Park.

On January 28, 1921, the Burnham Car Repair Co. was chartered under the laws of the State of Illinois. . . .

March 30, 1921, application was made by the Burnham Car Repair Co. to the secretary of state of Indiana for a license to operate as a foreign corporation in Indiana, which license was granted April 2, 1921. . . .

About March 29, 1921, a notice was posted by the carrier at Norpaul car-repair yards to the effect that the carrier would discontinue the operation of the yards on April 2.

Subsequently said yards were operated by J. H. Van Name, who was prior thereto an employee of the company. He operated these yards only a few weeks and then returned to the employ of the carrier. His contract contained a clause providing for its termination by either party on 10 days' notice.

Under date of September 16, 1921, the carrier entered into an agreement with the Burnham Car Repair Co. by which said company contracted to do all the carrier's car-repair work at Blue Island, Michigan Avenue, West Gibson, Gibson Transfer, Calumet Park, Norpaul, and Argo.

This contract evidently superseded all the above-mentioned prior car-repair contracts between said parties, and contained a number of new provisions, but in its main features is the same as its

predecessors. It covers all the car-repair work on said railroad. . . .

SEPTEMBER 16, 1921.

This agreement, made this 16th day of September, 1921, by and between the Indiana Harbor Belt Railroad Company, hereinafter called the "railroad," and Burnham Car Repair Co., hereinafter called the "car company."

In consideration of the mutual covenants and conditions hereinafter set forth, the parties hereto do agree as follows:

1. The car company agrees to make repairs at Blue Island, Ill., Michigan Avenue, Ind., West Gibson, Ind., Gibson Transfer (L. C. L.), Ind., Calumet Park, Ill., Norpaul, Ill., and Argo, Ill., in accordance with instructions of the railroad's foreman, such cars as the railroad may desire to have repaired. The car company agrees to make any repairs that the railroad may require it to make in its various yards, and agrees further to furnish such men for wrecking service as the railroad may call for. The railroad's foreman shall designate the work to be done by the car company on each car, and no repairs shall be made except as authorized by the railroad's foreman. All repairs shall be made in a manner satisfactory to the foreman of the railroad. Upon completion of repairs as ordered, the railroad foreman shall certify therefore as to quality, quantities, sizes and weights of materials used in said repairs. The railroad foreman shall have no authority to change this agreement, waive any of its provisions or permit any act or practice inconsistent therewith.

2. Tools, shop machinery, equipment and supplies necessary to carry on the repair work for the railroad shall be furnished by the railroad.

3. The car company may use the shops, machinery and equipment of the railroad located at Blue Island, Ill., Michigan Avenue, Ind., West Gibson, Ind., Gibson Transfer (L. C. L.), Ind., Calumet Park, Ill., Norpaul, Ill., and Argo, Ill., in making such repairs for the railroad and in making repairs for others, but repairs of the railroad shall at all times be given preference.

4. The railroad will maintain and own the material stock. It being understood that material on hand at Blue Island, Ill., Michigan Avenue, Ind., West Gibson, Ind., Gibson Transfer (L. C. L.), Ind., Calumet Park, Ill., Norpaul, Ill., and Argo, Ill., will be subject to supervision and inspection by the railroad storekeeper. As additional material is required requisitions will be made by the car company on a form to be prescribed and furnished by the railroad, such requisitions to be approved by the railroad master car builder. Monthly disbursement statement of material used will be prepared from the stock books as instructed by the master car builder.

5. Repair cards covering shall be made by the car company in accordance with A. R. A. rules which among other things provides

for a separate and individual card for each car repaired. Such repair cards for cars on which the repairs are completed shall be forwarded daily to the railroad master car builder at Gibson, Ind.

6. All scrap and reclaimed material other than lumber shall be separately listed on the bill for the car from which obtained and except as the railroad's representative shall designate it for use in these repairs, shall be returned by the car company to the railroad loaded on cars and shipped as directed by the railroad master car builder. . . .

7. Applied labor charged shall be in accordance with approved schedule of piecework rates of pay as effective January 1, 1921, which is attached and made a part hereof, and such additional schedules as may be hereafter approved by the railroad and accepted in writing by the car company, such schedules finally approved and accepted in writing to become a part of this contract.

8. The car company shall pay for all labor and supervision furnished by it in performing work for the railroad hereunder. As compensation for the work performed for the railroad hereunder, the railroad shall pay to the car company the actual cost of all labor engaged in performing work for the railroad, plus 5 per cent of the actual cost of said labor. The car company shall keep accurate account of all such expenditures and shall keep and furnish such other records, reports, and accounts as the railroad may require. The railroad shall have access at all reasonable times to the reports, records, and accounts of the car company for the purpose of determining the accuracy of its charges. The car company shall promptly, after the close of each calendar month, render, in the form prescribed by the master car builder of the railroad, a bill for the work on all cars completed and accepted by the railroad foreman during said month, and if correct, the railroad shall pay said bills within 30 days after the receipt of the same. The compensation as hereinbefore provided shall be accepted by the car company in full payment for work performed for the railroad under this contract.

9. The men in the employ of the car company will be required to familiarize themselves with the operating rules of the railroad in so far as pertaining to locking of switches, blue flag, and light protection and safety rules generally that are now in effect or that may hereafter become effective of which due and timely notice will be given.

10. The railroad company shall indemnify and save harmless the car company from any and all claim or claims for injury to or death of persons in any way arising or growing out of the car repair work performed by said car company for the railroad hereunder, whether such injury or death shall be due to the negligence of the car company or otherwise. If any suit be commenced against the car company separately or against the railroad and car company jointly upon any claim or claims in respect to which the railroad company has herein agreed to indemnify and save

harmless the said car company, then the railroad company shall upon notice of the pendency of such suit assume the defense of such suit and save the said car company harmless from all loss and from all cost by reason thereof.

11. The car company shall not be charged for the use of the railroad's tools, shops, machinery, equipment, or other facilities of the railroad while making repairs for the railroad, but the car company shall pay the railroad for the use of said tools, shops, machinery and equipment or other facilities of the railroad while making repairs for others than the railroad, amounts to be agreed upon by the railroad and the car company. If, at any time, the parties hereto are unable to agree upon amounts to be charged the car company for the use of the tools, shops, machinery, and equipment or other facilities of the railroad, said amount shall be determined by three arbitrators, one to be chosen by the railroad, one by the car company, and one by the two so chosen. If the arbitrators chosen by the parties hereto are unable to agree upon the third arbitrator, then the third arbitrator shall be appointed by any judge of a court of record in Cook County, Ill.

12. The car company shall furnish in form satisfactory to the railroad a bond for an amount of $15,000 conditioned for the faithful performance by the car company of this agreement, and indemnifying the railroad against any liens on account of work performed by the car company.

13. This agreement may be terminated by either party hereto by giving 60 days' written notice to the other party.

INDIANA HARBOR BELT RAILROAD CO.,
By GEORGE HANNAEUR,
BURNHAM CAR REPAIR CO.,
By JOHN W. JARANOWSKI.

Dispute arising from contracts.—Following the action of the carrier in contracting the car-repair work at Burnham, the grievance committee of the Brotherhood Railway Carmen of America representing the carmen employees, held a conference January 21, 1921, with the master car builder of the carrier. At this conference the action of the carrier in discharging its employees and contracting its shop work at Burnham was discussed, and the minutes of the conference, signed by both parties, contain this statement:

It was explained to the committee that this action was brought about by contract having been executed as between this company and the Burnham Car Repair Co., which contract specifies that they are to take over and operate this shop and facility.

As the other contracts hereinbefore referred to followed in rapid sequence, many communications were addressed to the carrier by

the representatives of the various classes of employees concerned, asking for conferences in which to consider the grievances of the employees arising from their discharge and from the arbitrary setting up by the carrier of new wages and working conditions by virtue of said contracts.

The carrier declined to hold any further conference with the representatives of the employees on the ground that it no longer had a car department, that the shop employees were the employees of the contractor and not of the carrier, and that said employees were not subject to the provisions of the transportation act, 1920.

Pursuant to the dispute which arose in the one conference held as aforesaid, and to the various refusals of the carrier to hold further conferences, the employees through their system federation filed two ex-parte disputes with the Railroad Labor Board, involving the questions herein considered. Operations under these contracts generated several incidental disputes, but they are all dependent on the one main question.

Opinion.—The employees contend:

(1) That the contracts involved herein are not in good faith, but are mere subterfuges, designed to evade the provisions of the transportation act and the decisions of the Railroad Labor Board; and

(2) That, even if the contracts are in good faith, they are in violation of the transportation act and in conflict with the decisions of the Railroad Labor Board.

The board is of the opinion that the employees failed to substantiate their contention that the contracts are actually fraudulent, and that they are mere subterfuges contrived to evade the transportation act. Obviously they do evade the act, but the carrier contends that it is a lawful evasion.

This contract system is not an innovation recently born of the desire to circumvent the transportation act. It existed long before the transportation act was ever dreamed of. In fact, it was practiced as far back as 1855 on the Philadelphia, Wilmington & Baltimore Railroad and it is pertinent to note that the actual operation of the trains on this road was let by contract.

This leads up to the remaining and principal issue in this case—namely, had the carrier the right to enter into such contracts as takes this class of employees from under the application of the transportation act and the jurisdiction of the Railroad Labor Board?

No more important dispute has ever come before the Labor Board for adjudication. It goes to the vitals of the transportation act. If the carrier can legally do the thing which has been done under these contracts, then the entire transportation act can be nullified and the will of the Congress of the United States set at naught. If one class of employees can thus be taken from under the application of the act, there is no sound reason why each and every railroad employee in the United States can not be given like treatment. One class of employment lends itself as readily to this method as another. Contracts have been recently entered into by various carriers, purporting to turn over to so-called independent contractors the work of the following classes of employees.

(1) The six shop crafts, (2) the maintenance of way employees, (3) certain employees embraced in the clerks' organization, (4) the firemen and oilers, (5) the hostlers, embraced in the engine service, and (6) the signal department employees.

It is intimated by the carrier that, perhaps, the actual operation of the trains could not be let to an independent contractor, because that would be a violation of the carrier's charter; that it would not be permitted to transfer the very power for the exercise of which it had been created, unless it delegated it to another common carrier. This is not a clear distinction, for the carrier in such a case would still be answerable to the public for the performance of its functions as a common carrier, and would not have contracted away this responsibility. It would merely have changed its method of paying its transportation employees, as it has its shop employees in the case under consideration.

The object of the transportation act was to prevent interruption to traffic, growing out of disputes between carriers and their employees. Such controversies had for years periodically harassed the public, blocked commerce, stagnated business, destroyed property values, and visited great inconvenience and suffering upon millions of people. At a time when our country was in no condition to undergo further repetitions of such unfortunate experiences and when they were possible on a much larger scale than ever before, Congress endeavored to provide a method for the adjustment of railway labor troubles. In the transportation act, 1920, the Government enjoins upon all carriers, and their officers, employees, and agents, the duty to "exert every reasonable effort and adopt every available means to avoid any interruption to the operation of any carrier, growing out of any dispute between the

carrier and the employees or subordinate officials thereof." Elaborate provisions are made in this act for conferences between the parties for the settlement of disputes and, in the event of a failure to agree, for the hearing and decision of them by adjustment boards and by the Railroad Labor Board.

When Congress in this act speaks of railroad employees it undoubtedly contemplates those engaged in the customary work directly contributory to the operation of the railroads. It is absurd to say that carriers and their employees would not be permitted to interrupt commerce by labor controversies unless the operation of the roads was turned over to contractors, in which event the so-called contractors and the railway workers might engage in industrial warfare ad libitum.

In other words, Congress did not say to the carriers, "you must not precipitate trouble by the adoption of arbitrary measures with your employees, but you may delegate to a contractor the power to violate and annul all your agreements, and if it happens to result in an interruption to traffic, the public will be deprived of such protection as the transportation act could give." As a matter of fact, that is practically the sole effect of the contracts involved in this case.

A strike by the employees of a contractor or contractor-agent of a carrier would as effectually result in an interruption to traffic as if the men were the direct employees of the carrier.

To the outside observer, and so far as the public is concerned, the car-repair department of this carrier has undergone no real change. The carrier's own shops along its own lines are maintaining the carrier's car equipment exactly as they did before these contracts were made. Very largely, the carrier's same foremen and inspectors are in charge and its same careful supervision is being exercised. The carrier is furnishing all the necessary material from its own stores and supply houses as it did before. The employees of the contractor are riding the carrier's shop train gratis from their homes to their work just as they did before, except that no passes are issued to them for fear of violating the law. When a wreck occurs anywhere on the carrier's property the employees of the contractor go out and look after it. The employees of the contractor are required to familiarize themselves with the operating rules of the railroad pertaining to safety. The carrier is carrying accident insurance on the contractor's employees. The carrier's tools, machinery, and equipment are all

being used in the operation, and the contractor had none of his own. The contractor has no leasehold on the plant or shops of the carrier. The carrier says it is free to do any of its work anywhere else, as it sees fit. On 60 days' notice, either party can terminate the contract. The contractor does not even have any control over the wages paid the employees. The contract contains the carrier's ready-made piecework schedule, which the contractor must use.

There need be no misunderstanding of this situation. The contractor performs only one useful function in this operation—he is the medium or channel through which the piecework system was substituted for the lawfully established wage scale. The contractor's compensation for this is 5 per cent of the amount of the pay roll, and the rate of pay is carefully limited by the piecework provisions in the contract. The contractor takes absolutely no risk.

The carrier was a party to Decisions Nos. 2 and 147 of the Railroad Labor Board, fixing wages for this class of employees. The carrier put into effect both of these decisions.

In the able brief of the carrier's counsel, several decisions of Federal courts are cited which construe contracts more or less similar to those involved herein and which define and construe the relationship of the railroad company, the contractor, and those who work for the contractor.

These cases involve the question of the railroad company's liability for injuries incurred by the contractor's employees, usually under the Federal employers' liability act.

None of these cases are in point here, because a different principle and a different statute are involved. The principle involved in all those cases is the duty and responsibility of the employer to the employee. The Federal employers' liability act has for its purpose the compensation of employees injured in the service of the employer.

That statute affected only the private relations between the employer and the employee. Naturally, it sought no purpose and contained no provision that could be construed as a denial of the carrier's right to contract its work and relieve itself of liability for injury to employees and others.

On the other hand, the transportation act was not enacted primarily for the protection of the rights of either carrier or employee, except in so far as such protection was involved in the

paramount purpose of the act; that is, to insure to the public, as far as possible, efficient and uninterrupted railway transportation by protecting the people from the loss and suffering incident to the interruption to traffic growing out of controversies between the carriers and the employees who do their work. This act is the congressional assertion of a public right.

It may seem immaterial to the public what method or arrangement the carrier adopts to secure the performance of the work essential to its operation. But it is immensely important to the public that this work be carried on in a peaceful and orderly manner. It may seem immaterial to the public for the carrier to contract any of its work. But it is important if by such contract the carrier seeks to remove its employees from under the application of a law which the people have enacted for the purpose of maintaining industrial peace on the railways. There is a public interest in the carrier's methods greater than may appear on the surface. The contracts herein involved violate the spirit and purpose of the transportation act, and in effect set aside the wage decisions of the Railroad Labor Board to which the carrier was a party and which the carrier put into effect.

To all intents and purposes, the contractor's operations constitute a department of the carrier, with a piecework system which has been forced upon the men by the discharge of some and the dread of discharge and unemployment of others, and which has never been submitted to the Railroad Labor Board in the form of a dispute, as a compliance with the statute requires. The contractor is, in effect, merely an agent of the carrier.

The board can understand how the carrier reached the conclusion that it had the right to make such contracts, because somewhat similar ones had been made through a long course of years; but those precedents have been robbed of their potency by the enactment of the transportation act, which the courts of the country, without exception so far, have declared to be constitutional.

Decision.—The Railroad Labor Board therefore decides:

(1) That the various contracts entered into between the Indiana Harbor Belt Railroad Co. and the Burnham Car Repair Co., for the operation of its railway shops, and particularly the one bearing date of September 16, 1921, are in violation of the transportation act, 1920, in so far as they purport or are constructed by the carrier to remove said employees from the application of said act,

and that those provisions of the contracts affecting the wages and working rules of said employees are in violation of Decisions Nos. 2, 119, and 147 of the Railroad Labor Board.

(2) That the shop employees of said contractor are under the jurisdiction of the Railroad Labor Board and subject to the application of the transportation act, 1920, and Decision No. 147.

(3) The carrier is directed to take up with any employee the matter of reinstatement upon the application of the interested employee or his representative.

This decision rests upon the facts of this particular case, and the decision of each of the other contract cases pending before the Labor Board will rest upon its own facts and the general principles herein declared.

3. Employee Representation [1]

This case involves the construction of Title III of the Transportation Act of 1920, c. 91, 41 Stat. 456, 469. The Title provides for the settlement of disputes between railroad companies engaged in interstate commerce and their employees, and as a means of securing this, it creates a Railroad Labor Board and defines its functions and powers.

The Pennsylvania Railroad Company began this action by a bill in equity against the Railroad Labor Board and its individual members in the District Court for the Northern District of Illinois, where the Board has its office, averring that the suit involved more than $3,000, and praying an injunction against the defendants' alleged unlawful proceedings under the act and especially against their threatened official publication under § 313 of the Title that the Railroad Company had violated the Board's decision under the act.

The defendants moved to dismiss the bill on the ground that the suit was one against the United States without its consent, and also for want of equity and a lack of a cause of action. They also filed an answer making the same objections to the bill as in the motion and setting forth by exhibits more in detail the proceedings before the Board and its decisions. The District Court heard the case on the bill, motion and answer, and granted the injunction as prayed. The Board appealed to the Circuit Court of Appeals, which reversed the decree and directed the dismissal

[1] *Pennsylvania Railroad Company* v. *United States Railroad Labor Board*, 261 U. S. 72 (February 19, 1923). See Vanderblue and Burgess, pp. 387–388, and Jones, p. 574 n.

of the bill. The decree of the Circuit Court of Appeals, not being made final by the statutes, the case is brought here by appeal under § 241 of the Judicial Code.

On December 28, 1917, the President, by authority of the Act of Congress of August 29, 1916, c. 418, 39 Stat. 619, 645, took over the railroads of the country, including that of the complainant, and operated them through the Director General of Railroads until March 1, 1920, when, pursuant to the Transportation Act of 1920, possession of them was restored to the companies owning them. During his operation, the Director General had increased wages and established the rules and working conditions by what were called National Agreements with National Labor Unions composed of men engaged in the various railroad crafts. Further demands by employees through such unions were presented to the Director General and were pending and undetermined when the Transportation Act was approved. Conferences were held between the heads of the labor unions, signatories to the National Agreement, and representatives of the railroads after the railroads were restored to private ownership, but without successful issue. When the members of the Labor Board were appointed and organized, April 15, 1920, it assumed jurisdiction of these demands and proceeded to deal with them. It rendered its decision as to the wage dispute on July 20, 1920, and postponed that as to rules and working conditions until April 14, 1921, when it decided that such rules and working conditions as were fixed in the so-called National Agreements under the Director General and had been continued by the Board as a *modus vivendi* should end July 1, 1921, and remanded the matter to the individual carriers and their respective employees, calling upon them in the case of each railroad to designate representatives to confer and decide so far as possible respecting rules and working conditions for the operation of such railroad and to keep the Board advised of the progress toward agreement. The Board accompanied this decision (No. 119) with a statement of principles or rules of decision which it intended to follow in consideration and settlement of disputes between the carriers and employees. The only two here important are §§ 5 and 15, as follows:

"5. The right of such lawful organization to act toward lawful objects through representatives of its own choice, whether employees of a particular carrier or otherwise, shall be agreed to by management.

"15. The majority of any craft or class of employees shall have the right to determine what organization shall represent members of such craft or class. Such organization shall have the right to make an agreement which shall apply to all employees in such craft or class. No such agreement shall infringe, however, upon the right of employees not members of the organization representing the majority to present grievances either in person or by representatives of their own choice."

On June 27, 1921, the Board announced that some carriers in conference with their employees had agreed upon rules and working conditions and others had not. As to the latter the Board continued the old rules and working conditions until it should render a decision as to them.

In May, 1921, the officers of the Federation of Shop Crafts of the Pennsylvania System, a labor union of employees of that System engaged in shop work, and affiliated with the American Federation of Labor, met the representatives of the Pennsylvania Railroad Company. They said they represented a majority of the employees of the Pennsylvania System in those crafts and were prepared to confer and agree upon rules and working conditions. The Pennsylvania representatives refused to confer with the Federation for lack of proof that it did represent such a majority, and said they would send out a form of ballot to their employees asking them to designate thereon their representatives. The Federation officers objected to this ballot because it was not in accordance with Principles 5 and 15 of the Board in that it made no provision for representation of employees by an organization, but specified that those selected must be natural persons, and such only as were employees of the Pennsylvania Company, and also because it required that the representatives of the employees should be selected regionally rather than from the whole system. The result was that the company and the Federation each sent out ballots. The Federation then filed a complaint under § 307 of the Transportation Act, against the Pennsylvania Company, complaining on behalf of its members directly interested of the Company's course in respect of the ballots. The Company appeared, a hearing was had and the Board decided (Decision No. 218) that neither of the ballots sent out by the parties was proper, that representatives so chosen were not proper representatives and that rules and working conditions agreed upon by them would be void. It further appeared that the votes cast on the Company's

ballots were something more than 3,000 out of more than 33,000 employees entitled to vote. The Federation had advised its members not to vote on the Company's ballots. What the result was in the vote of the Federation ballots did not appear. The persons chosen by the 3,000 votes on the Company's ballots conferred with the Pennsylvania Company's representatives and agreed upon rules and working conditions. The Board in its decision ordered a new election for which rules were prescribed and a form of ballot was specified, on which labor organizations as well as individuals could be voted for as representatives at the option of the employee.

The Company on September 16, 1921, applied to the Board to vacate this decision on the ground that there was no dispute before the Board of which by Title III of the Transportation Act the Board was given jurisdiction. After a hearing the Board declined to vacate its order but said that it would allow the Company to be heard on the question of the ratification of its shop craft rules by representatives of the crafts concerned when fairly selected.

Title III of the Transportation Act of 1920 bears the heading "Disputes Between Carriers And Their Employees And Subordinate Officials."

Section 301 makes it the duty of carriers, their officers, employees and subordinate officials, to exert every reasonable effort to avoid interruption to the operation of an interstate commerce carrier due to a dispute between the carrier and its employees, and further provides that such disputes shall be considered and if possible decided "in conference between representatives designated and authorized so to confer by the carriers, or the employees or subordinate officials thereof, directly interested in the dispute."

The section concludes:

"If any dispute is not decided in such conference, it shall be referred by the parties thereto to the board which under the provisions of this title is authorized to hear and decide such dispute."

Section 302 provides for the establishment of railroad boards of adjustment by agreement between any carrier, group of carriers, or the carriers as a whole, and any employees or subordinate officials of carriers, or organization or groups of organizations thereof. No such boards of adjustment were established when this controversy arose.

Section 303 provides for hearing and decision by such boards of adjustment upon petition of any dispute involving only griev-

ances, rules or working conditions not decided as provided in § 301.

Sections 304, 305 and 306 provide for the appointment and organization of the "Railroad Labor Board" composed of nine members, three from the Labor Group, three from the Carrier Group, and three from the Public Group.

Section 307 (a) provides that when a labor adjustment board under § 303 has not reached a decision of a dispute involving grievances, rules or working conditions in a reasonable time, or when the appropriate adjustment board has not been organized under § 302, the Railroad Labor Board "(1) upon the application of the chief executive of any carrier or organization of employees or subordinate officials whose members are directly interested in the dispute, (2) upon a written petition signed by not less than 100 unorganized employees or subordinate officials directly interested in the dispute, or (3) upon the Labor Board's own motion if it is is of the opinion that the dispute is likely substantially to interrupt commerce, shall receive for hearing, and as soon as practicable and with due diligence decide, any dispute involving grievances, rules, or working conditions which is not decided as provided in section 301."

Paragraph (b) of the same section provides for a hearing and decision of disputes over wages.

Paragraph (c) makes necessary to a decision of the Board the concurrence of five members, of whom, in the case of wage disputes, a member of the Public Group must be one. The paragraph further provides that

"All decisions of the Labor Board shall be entered upon the records of the board and copies thereof, together with such statement of facts bearing thereon as the board may deem proper, shall be immediately communicated to the parties to the dispute, the President, each Adjustment Board, and the [Interstate Commerce] Commission, and shall be given further publicity in such manner as the Labor Board may determine."

Paragraph (d) requires that decisions of the Board shall establish standards of working conditions which in the opinion of the Board are just and reasonable.

Section 308 prescribes other duties and powers of the Labor Board, among which is that of making "regulations necessary for the efficient execution of the functions vested in it by this title."

Section 309 prescribes that:

"Any party to any dispute to be considered by an Adjustment Board or by the Labor Board shall be entitled to a hearing either in person or by counsel."

Section 313 is as follows:

"The Labor Board, in case it has reason to believe that any decision of the Labor Board or of an Adjustment Board is violated by any carrier, or employee or subordinate official, or organization thereof, may upon its own motion after due notice and hearing to all persons directly interested in such violation, determine whether in its opinion such violation has occurred and make public its decision in such manner as it may determine."

Mr. Chief Justice Taft, after stating the case as above, delivered the opinion of the Court.

It is evident from a review of Title III of the Transportation Act of 1920 that Congress deems it of the highest public interest to prevent the interruption of interstate commerce by labor disputes and strikes, and that its plan is to encourage settlement without strikes, first by conference between the parties; failing that, by reference to adjustment boards of the parties' own choosing, and if this is ineffective, by a full hearing before a National Board appointed by the President, upon which are an equal number of representatives of the Carrier Group, the Labor Group, and the Public. The decisions of the Labor Board are not to be enforced by process. The only sanction of its decision is to be the force of public opinion invoked by the fairness of a full hearing, the intrinsic justice of the conclusion, strengthened by the official prestige of the Board, and the full publication of the violation of such decision by any party to the proceeding. The evident thought of Congress in these provisions is that the economic interest of every member of the Public in the undisturbed flow of interstate commerce and the acute inconvenience to which all must be subjected by an interruption caused by a serious and widespread labor dispute, fastens public attention closely on all the circumstances of the controversy and arouses public criticism of the side thought to be at fault. The function of the Labor Board is to direct that public criticism against the party who, it thinks, justly deserves it.

The main and controlling question in this case is, whether the members of the Board exceeded their powers on the facts as disclosed in the bill and answer.

It is contended by the carrier that the Labor Board cannot obtain jurisdiction to hear and decide a dispute until it is referred by the parties to the Board after they have conferred and failed to agree under § 301. Undoubtedly the act requires a serious effort by the carrier and his employees to adjust their differences as the first step in settling a dispute but the subsequent sections dispel the idea that the jurisdiction of the Board to function in respect to the dispute is dependent on a joint submission of the dispute to it. If adjustment boards are not agreed upon, then under § 307, either side is given an opportunity to bring its complaint before the Labor Board, which then is to summon everyone having an interest, and after a full hearing is to render a decision. A dispute existed between all the carriers and the officers of the National Labor Unions as to rules and working conditions in the operation of the railroads. By order of the Labor Board, this dispute, which had arisen before the passage of the Transportation Act and before the Government had turned back the railroads to their owners, was continued for settlement before the Labor Board. That Board had been obliged to postpone the decision of the controversy until it could give it full hearing and meantime had ordered that the existing rules and conditions should be maintained as a *modus vivendi*.

Counsel of the Railroad Company insist that the Board had no jurisdiction to make an order or to take up the controversies between the Government Railroad Administration and the National Labor Unions; that when the railroads were turned back to their owners each company had the right to make its own rules and conditions and to deal with its own employees under § 301, and that the jurisdiction of the Board did not attach until a dispute as to such rules and conditions between the company and its employees had thereafter arisen.

We are not called upon to pass upon the propriety or legality of what the Labor Board did in continuing the existing rules and labor conditions which had come over from the Railroad Administration, or in hearing an argument as to their amendment by its decision. It suffices for our decision that the Labor Board at the instance of the carriers finally referred the whole question of rules and labor conditions to each company and its employees to be settled by conference under § 301; that such conferences were attempted in this case, and that thereafter the matter was brought before the Board by Federation No. 90 of Shop Crafts of the

Pennsylvania System under § 307. It is the alleged invalidity of this proceeding, thus initiated, which is really the basis of the bill of complaint of the Company herein, and it is this only which we need consider.

First, Did Federation No. 90 have the right under § 307 to institute the hearing of the dispute? Section 307 says that this may be invoked on the application of the chief executive of any organization of employees whose members are directly interested in the dispute. Its name indicates, and the record shows, that the Federation is an association of employees of the Pennsylvania Company directly interested in the dispute. The only question between the Company and the Federation is whether the membership of the latter includes a majority of the company's employees who are interested. But it is said that the Federation is a labor union affiliated with the American Federation of Labor and that the phrase "organization of employees" used in the act was not intended by Congress to include labor unions. We find nothing in the act to impose any such limitation if the organization in other respects fulfills the description of the act. Congress has frequently recognized the legality of labor unions, *United Mine Workers* v. *Coronado Coal Co.*, 259 U. S. 344, and no reason suggests itself why such an association, if its membership is properly inclusive, may not be regarded as among the organizations of employees referred to in this legislation.

The next objection made by the Company to the jurisdiction of the Board to entertain the proceeding initiated by the Federation is that it did not involve the kind of dispute of which the Board could take cognizance under the act. The result of the conferences between the Pennsylvania Railroad Company and its employees under § 301 appears in the statement of the case. By a vote of 3,000 out of more than 30,000 employees, a representative committee was appointed with which the officers of the Company made an agreement as to rules and working conditions. Federation No. 90 for its members objected to the settlement on the ground that it had not been made by properly chosen representatives of the employees and brought this dispute before the Labor Board. The Pennsylvania Company was summoned and appeared before the Board and the issue was heard.

It is urged that the question who may represent the employees as to grievances, rules and working conditions under § 301 is not within the jurisdiction of the Labor Board to decide; that these

representatives must be determined before the conferences are held under that section; that the jurisdiction of the Labor Board does not begin until after these conferences are held, and that the representatives who can make application under § 307 to the Board are representatives engaged in the conference under § 301. Such a construction would give either side an easy opportunity to defeat the operation of the act and to prevent the Labor Board from considering any dispute. It would tend to make the act unworkable. If the Board has jurisdiction to hear representatives of the employees, it must of necessity have the power to determine who are proper representatives of the employees. That is a condition precedent to its effective exercise of jurisdiction at all. One of its specific powers conferred by § 308 is to "make regulations necessary for the efficient execution of the functions vested in it by this title." This must include the authority to determine who are proper representatives of the employees and to make reasonable rules for ascertaining the will of the employees in the matter.

Again, we think that this question of who may be representatives of employees, not only before the Board, but in the conferences and elsewhere is and always has been one of the most important of the rules and working conditions in the operation of a railroad. The purpose of Congress to promote harmonious relations between the managers of railways and their employees is seen in every section of this act, and the importance attached by Congress to conferences between them for this purpose is equally obvious. Congress must have intended, therefore, to include the procedure for determining representatives of employees as a proper subject matter of dispute to be considered by the Board under § 307. The act is to be liberally construed to effect the manifest effort of Congress to compose differences between railroad companies and their employees, and it would not help this effort, to exclude from the lawful consideration of the Labor Board a question which has so often seriously affected the relations between the companies and their employees in the past and is often encountered on the very threshhold of controversies between them.

The second objection is that the Labor Board in Decision 119 and Principles 5 and 15, and in Decision 218, compels the Railroad Company to recognize labor unions as factors in the conduct of its business. The counsel for the Company insist that the right to deal with individual representatives of its employees as to rules

and working conditions is an inherent right which can not be constitutionally taken from it. The employees, or at least those who are members of the labor unions, contend that they have a lawful right to select their own representatives, and that it is not within the right of the Company to restrict them in their selection to employees of the Company or to forbid selection of officers of their labor unions qualified to deal with and protect their interests. This statute certainly does not deprive either side of the rights claimed.

But Title III was not enacted to provide a tribunal to determine what were the legal rights and obligations of railway employers and employees or to enforce or protect them. Courts can do that. The Labor Board was created to decide how the parties ought to exercise their legal rights so as to enable them to coöperate in running the railroad. It was to reach a fair compromise between the parties without regard to the legal rights upon which each side might insist in a court of law. The Board is to act as a Board of Arbitration. It is to give expression to its view of the moral obligation of each side as members of society to agree upon a basis for coöperation in the work of running the railroad in the public interest. The only limitation upon the Board's decisions is that they should establish a standard of conditions, which, in its opinion, is just and reasonable. The jurisdiction of the Board to direct the parties to do what it deems they should do is not to be limited by their constitutional or legal right to refuse to do it. Under the act there is no constraint upon them to do what the Board decides they should do except the moral constraint, already mentioned, of publication of its decision.

It is not for this or any other court to pass upon the correctness of the conclusion of the Labor Board if it keeps within the jurisdiction thus assigned to it by the statute. The statute does not require the Railway Company to recognize or to deal with, or confer with labor unions. It does not require employees to deal with their employers through their fellow employees. But we think it does vest the Labor Board with power to decide how such representatives ought to be chosen with a view to securing a satisfactory coöperation and leaves it to the two sides to accept or reject the decision. The statute provides the machinery for conferences, the hearings, the decisions and the moral sanction. The Labor Board must comply with the requirements of the statute; but having thus complied, it is not in its reasonings and conclusions

limited as a court is limited to a consideration of the legal rights of the parties.

The propriety of the Board's announcing in advance of litigated disputes the rules of decision as to them is not before us except as to Principles 5 and 15 of Decision No. 119, so far as they determine the methods by which representatives of employees should be selected. They were applied and followed in the form of ballot prescribed by Decision 218. These decisions were necessary in order that conferences should be properly begun under § 301, and that disputes there arising should be brought before the Board. They were therefore not premature. It is not for us to express any opinion upon the merits of these principles and decisions. All that we may do in this case is to hold as we do, that they were within the lawful function of the Board to render, and not being compulsory, violate no legal or equitable right of the complaining company.

For this reason, we think that the District Court was wrong in enjoining the Labor Board from proceeding to entertain further jurisdiction and from publishing its opinions, and that the Court of Appeals was right in reversing the District Court and in directing a dismissal of the bill. We do not find it necessary, therefore, to consider the questions raised at the bar as to whether the Railroad Labor Board is a corporation under the act and capable of suing or being sued, without the consent of the United States, and whether the Board's publication of its opinions in matters beyond its jurisdiction could be properly enjoined by a court of equity.[1]

Decree affirmed.

[1] Subsequent to the decision of the Supreme Court reproduced above, the Railroad Labor Board, on June 12, 1923, issued a decision (No. 1829), in which it found that the Pennsylvania Railroad Company had violated Decision No. 218 of the board, after the Supreme Court had upheld the board's right to render said decision, and that the railroad had thereby denied to its shop employees essential rights to which Congress had declared them entitled. Decisions of the United States Railroad Labor Board, vol. 4, p. 387. Notwithstanding the decision of the Supreme Court and of the Labor Board the controversy between the Pennsylvania Railroad and the Federated Shop Crafts continued. The controversy led to another decision by the Supreme Court. In Pennsylvania Railroad System and Allied Lines Federation No. 90 *v.* Pennsylvania Railroad, decided on March 2, 1925, the Court pointed out that the Pennsylvania "is using every endeavor to avoid compliance with the judgment and principles of the Labor Board as to the proper method of securing representatives of the whole body of its employees, it is seeking to control its employees by agreements free from the influence of an independent trade union, it is, so far as its dealings with its employees go, refusing to comply with the decisions of the Labor Board and is thus defeating the purpose of Congress." But, said the Court, "all these things it might do and remain within its strict legal rights. . . . We do not think Congress, while it would deprecate such action, intended to make it criminal or legally actionable." The bill of the Federated Shop Crafts was therefore dismissed.—Ed.

CHAPTER XXVII

STRIKES[1]

1. Shopmen's Wages Reduced: Railroad Labor Board Decision No. 1036[2]

Subject of the dispute.—Between each of the carriers named below and the class of employees represented by the organizations named below disputes have arisen as to what shall constitute just and reasonable wages.

Conferences were held between each carrier and the accredited representatives of its said employees, and said disputes, not having been decided in such conferences, were referred to the United States Railroad Labor Board for decision.

All the carriers named below are petitioning for a reduction in the wages of said employees, and on a considerable number of the roads the employees are requesting an increase in wages.

Both parties made a full presentation to the Labor Board of their respective contentions, by testimony and argument, oral and written.

Parties to the dispute.—The following carriers are parties to this dispute:

. . . .

The organizations which are parties hereto, representing the employees involved herein, and each of which has a dispute with one or more of the above-named carriers, are as follows:

Railway Employees' Department, A. F. of L. (Federated Shop Crafts).

American Federation of Railroad Workers.

International Association of Railroad Supervisors of Mechanics.

History of the controversy.—The Railroad Labor Board by Decision No. 2, effective May 1, 1920, increased the wages of this class of employees, along with others, on all the railroads then before

[1] See Jones, pp. 414, 417–418, 420–426, 428–431, 575–578, 580–585, and Vanderblue and Burgess, pp. 383, 390–392, 394–395.

[2] *Alabama and Vicksburg Railway Company et al.* v. *Railway Employees' Department, A. F. of L. (Federated Shop Crafts), et al.*, Decisions of United States Railroad Labor Board, vol. 3, p. 423 (June 5, 1922).

the board. That decision was rendered at a time when living costs and wages were at their summit. Shortly afterwards living costs and wages in general began to decline.

The Labor Board by Decision No. 147, effective July 1, 1921, reduced the wages of this class of employees on all the carriers before the board.

These two decisions, Nos. 2 and 147, were handed down by the board after a full hearing of all parties. The board endeavored in said cases, as it does in the present one, to observe the provisions of the transportation act, 1920, prescribed for its guidance, which reads as follows:

SEC. 307 (*d*) * * * In determining the justness and reasonableness of such wages and salaries or working conditions the board shall, so far as applicable, take into consideration among other relevant circumstances:

(1) The scales of wages paid for similar kinds of work in other industries;
(2) The relation between wages and the cost of living;
(3) The hazards of the employment;
(4) The training and skill required;
(5) The degree of responsibility;
(6) The character and regularity of the employment; and
(7) Inequalities of increases in wages or of treatment, the result of previous wage orders or adjustments.

The wages of the respective crafts herein referred to were practically uniform throughout the country by orders of the United States Railroad Administration, which rates were in effect immediately prior to the issuance of Decision No. 2 of the Labor Board, which was effective May 1, 1920. Under that decision new rates were established by adding the increase of a certain number of cents per hour.

The reductions made by Decision No. 147 were similarly arrived at by applying to the various rates established by Decision No. 2 a uniform decrease of a certain number of cents per hour.

Basis and analysis of decision.—In this case, the Labor Board adopts as its base the rates fixed in Article IV of Decision No. 147, and finds it just and reasonable under the law and the evidence to make the following schedule of decreases per hour:

SEC. 1. Supervisory forces whether paid by the month or by the hour.......................... No decrease.

SEC. 2 (*a*) Machinists, boiler makers, blacksmiths, sheet-metal workers, electrical workers, carmen (except freight carmen), molders, cupola tenders and coremakers, including those with less than four years' experience, all crafts	7 cents.
(*b*) Freight carmen	9 cents.
SEC. 3. Regular and helper apprentices and helpers, all classes	7 cents.
SEC. 4. Car cleaners	5 cents.

The Labor Board is of the opinion that after the reductions made under this decision, shop employees on the railroads will still be receiving, as a rule, a wage in excess of that paid to similar employees in other industries.

The foregoing table of decreases has the effect of maintaining the uniform rates for the respective classes which were continued by Decisions Nos. 2 and 147. It will be noted that the differential between "freight carmen" and the other classes have been increased 2 cents per hour by providing a decrease of 9 cents per hour for this class as compared with 7 cents per hour for the other crafts named. The board recognizes that there are certain branches of carmen's work which require the service of skilled mechanics, and for the classes so considered this decision provides a decrease of 7 cents per hour. It is, however, believed that the work of "freight carmen" is not of a character which requires the service of men as skilled as in other branches of work coming within the scope of carmen's work; therefore the differential between the minimum rates of "freight carmen" and of the other shop crafts under this decision will be increased to 7 cents per hour, which it is felt is just and reasonable considering the character of service performed and the rates of pay and working conditions applicable to this class of employees prior to the issuance of any wage order by the United States Railroad Administration.

It will be further noted that no decrease is provided herein for "supervisory forces." The board, after due consideration, feels that the duties and responsibilities of these positions are of such a character as to warrant the maintenance of the present rates.

Based upon the evidence before the Labor Board, the statistical department of the board has made a study of the comparative purchasing power of the wage herein fixed for certain of the shop crafts and the purchasing power of the wage paid such employees on the railroads in December, 1917, immediately prior to Government control of the carriers; in January, 1920, just prior to the

termination of Federal control; on May 1, 1920, the effective date of Decision No. 2; on July 1, 1921, the effective date of Decision No. 147; and in March, 1922.

The results of these studies are as follows:

AVERAGE HOURLY RATES

	Machinists	Car men.
	Cents.	*Cents.*
December, 1917	50.5	37.7
January, 1920	72.3	68.0
May, 1920	85.3	81.0
July, 1921	77.3	73.0
Under present decision	70.3	64.4

PERCENTAGE OF INCREASE IN AVERAGE HOURLY RATES OVER DECEMBER, 1917

January, 1920	43.2	80.4
May, 1920	68.9	114.6
July, 1921	53.0	93.6
Under present decision	39.2	70.8

PERCENTAGE OF INCREASE IN COST OF LIVING OVER DECEMBER, 1917

January, 1920	40.0	....
May, 1920	52.0	....
July, 1921	26.7	....
March, 1922 (latest available Government data)	17.2	....

PERCENTAGE OF INCREASE IN PURCHASING POWER OF EARNINGS OF SUBSEQUENT DATES AS COMPARED WITH DECEMBER, 1917

January, 1920	2.3	28.9
May, 1920	11.1	41.2
July, 1921	20.8	52.8
Under present decision	18.8	45.7

Although average hourly earnings of machinists are below the earnings after Decision No. 2 was applied by 15 cents per hour, their value is 6.9 per cent greater due to the decrease in the cost of living.

The average hourly earnings of carmen are below the earnings

after Decision No. 2 was applied by 16.6 cents per hour, but their value is 3.2 per cent greater for the same reason.

The cost-of-living figures set out in the foregoing tables have been compiled from the reports of the United States Department of Labor and are for the latest date for which such data are available.

Decision.—The Railroad Labor Board therefore decides:

(1) That the rates of wages heretofore established by the authority of the United States Railroad Labor Board shall be decreased as hereinbefore set out for the classes of employees there named, and that such decreases shall be effective as of July 1, 1922.

(2) That the scope of this decision is limited to the carriers named under Article I herein, to such carriers as may be included hereafter by addenda, and to the specific classes of employees named or referred to under each particular carrier.

(3) That the reduction in wages hereby authorized shall be made in accordance with the following articles, which prescribe the regulations and designate the employees affected. . . .

DISSENTING OPINION.

The undersigned dissent from the majority decision for the following specific reasons:

(1) The wage structure for the transportation industry which is being built up in this series of decisions rests upon no consideration of the human needs of the employees affected. These human needs were set forth by data and witnesses at the recent hearings with compelling force. The majority have not considered the evidence on this point, nor have they met the issue raised. Their failure to give this, the most vital element, consideration and to inform the public impartially on the subject, vitiates the whole decision.

(2) The evidence submitted in the recent hearings tended to show that an income based on the 77-cent per hour rate does not enable representative shop-craft families with the most economical management to procure enough food for their families or to maintain their own efficiency. This evidence included a tentative standard of living expressed in terms of goods and services to which mechanics naturally feel themselves entitled. At the current prices an increase in pay would be necessary to enable these employees to secure such a standard. Without any attempt to show that the employees affected by this decision are not entitled to

such a standard, and further without any attempt to show how families can make good the food deficits, the majority decision further reduces the ability of these employees to meet the needs of their families. The undersigned dissenting members feel that the Labor Board must initiate a study which shall determine the amount necessary to meet some recognized standard, that it must use the results as a basis for its decisions, and that it must through this decision transmit this information to the public.

(3) The rates of pay contained in the award, being insufficient to provide for a family of five, tend to substantiate the position taken by management to the effect that wages need not be established with reference to the needs of a family of this size. The most careful and comprehensive investigation on this subject shows that wages which do not provide for a family of that size mean that 72 per cent of all children in families receiving this wage will be inadequately provided for during at least five critical years of their lives. Permanent traces of this malnutrition will be left on the physique of the next generation.

(4) The failure of the majority to consider the real merits of the case has created a wage structure which has no relation to any existing standards. Based on evidence in possession of the Labor Board, the minimum for the industry should have been nothing less than 50 cents per hour. Without for the moment questioning the justice of the differentials resulting from the majority decision, this would place the mechanics' rate at least as high as 87 cents per hour.

(5) The ordering of a larger decrease in the case of freight carmen is unjust and wholly inconsistent with former decisions of the Labor Board. In ordering such a change, the majority disregard the fact that any difference in skill which may exist has been already provided for in the 5-cent differential which dates from the days of the United States Railroad Administration. They also disregard the fact that under the classification rules of the board freight carmen are mechanics and as such are entitled to the minimum rate for mechanics.

(6) The rates of pay established in this decision will mean to the employees affected lower purchasing power and lower standards as compared with pre-war years. From December, 1917, to the present decision, inclusive, the maintenance of equipment forces have suffered a constant deficit, their wages at all times failing to keep pace with living costs. The figures cited by the

majority to the contrary effect are a misrepresentation of the true facts as to the relative earnings involved.

(7) The savings to the railroads, as a result of the decisions of the Labor Board and of the lay-off of men, far exceed anything justified by the savings to the public in reduced rates. The employees covered by this decision alone have had their pay roll cut to the extent of $371,817,996 per year, as hereinafter set out, based on number of employees in service as of December, 1917, while the total pay-roll cuts due to decisions alone total more than half a billion dollars. During the last six months of 1921 the total pay-roll slash, including the lay-offs, was running at the annual rate of $1,300,000,000. This diminished purchasing power of the employees as a group appears in strong contrast with the increasing prosperity of the railroads noted by the Interstate Commerce Commission in its recent opinion and by the financial press.

(8) The increasing antithesis between profits and just wages will result in lower morale among the railroad employees; thus the present wage reductions will not result in economies and will prove contrary to the real needs of efficient and economical management.

(9) The majority have failed to carry out the function for which the Labor Board was created. Such decisions containing no explanation of the process by which the majority arrive at the rates established, give the public an impression that these rates are not founded upon a careful consideration of the facts. A strong contrast is presented with the decisions of other wage boards, not only in this country, but in other parts of the world, as well as with the decisions of the Interstate Commerce Commission, which show the public at considerable length how the evidence was weighed and the conclusions reached.

In the light of the transportation act it is the clear duty of the Board: First, to act as a constructive, impartial body in providing means whereby railroad employees can have their legitimate human needs satisfied without recourse to stoppages; and, secondly, to enlighten the public so that through the disordered state of unregulated industry and the confusion of propaganda, they shall be able to see the real facts as they affect the body politic. The decision in question fulfills neither of these duties.

These reasons for our dissent are dealt with briefly in the order enumerated.

THIS DECISION MUST BE CONSIDERED AS RELATED TO THE PRECEDING DECISION.

This decision is one of a series covering the various groups of railroad employees, but the problem will be misunderstood if these decisions are considered separately. Together they really constitute a single decision which determines for the time being the wage structure of the industry. The problem involved in this series of decisions has been clearly stated by Justice Higgins, already quoted, as follows:

> The court adhered to its practice of dividing the minimum wage awarded into two parts: "The basic wage"—the minimum to be awarded to unskilled laborers on the basis of "the normal needs of an average employee regarded as a human being living in a civilized community"; and the other, the "secondary wage"—the extra payment to be made for trained skill or other exceptional qualities necessary for an employee exercising the functions required. (Harvard Law Review, Vol. XXXII, No. 3, p. 191.)

Obviously, the justice of the entire wage structure in an industry rests upon the justice of the "basic wage." The justness of this basic wage depends upon the extent to which the board treats "the proper sustenance of the persons employed on the basis of a family life * * * as a first charge on the product," to use the phrases of Justice Higgins.

This decision, in effect, establishes a group of secondary wages or differentials. Such a decision can be just and reasonable only to the extent that it is based on a primary wage determined through exhaustive study of the human needs of the common laborer's family, coupled with a systematic determination of the differentials of skill and responsibility represented in the occupations covered, and of the differentials of payment necessary to secure and encourage the requisite ability. If the Labor Board had determined the section man's wage rate on a just and reasonable basis, we should not here be concerned with the minimum amount necessary to sustain a family, any more than Congress was so concerned when it fixed the salaries of members of the Labor Board.

According to Justice Higgins, the court is to-day working on the basis of a minimum wage determined by a rough estimate of what was necessary to support a family in Melbourne in 1907, which is varied according to changes in the cost of living. It is interesting to note that this basic wage raised the minimum to a level over 27

per cent above the then existing average for unskilled labor. But according to Justice Higgins, "There is no doubt that the rough estimate made by the court in 1907 ought to be superseded or revised by a new investigation made after so many years have elapsed as to the absolute present cost of living."

Now such an investigation of the absolute cost of living as the basis for the minimum wage in the transportation industry is clearly within the function of the United States Railroad Labor Board. It is, in fact, its duty. The first principle laid down in the transportation act to govern decisions of the Board is:

> The relation between wages and the cost of living.

This, clearly, is the principle which must be given primary consideration in the determination of the basic minimum of the whole wage structure. It is also a point on which the public has a right to ask information.

EVIDENCE BEFORE THE BOARD ON ABSOLUTE COST OF LIVING NOT CONSIDERED.

The center of the case presented by the employees dealt with the question of the actual cost of the necessities of family life. This evidence consisted of far more than the pricing of "theoretical" family budgets. It included the actual monthly expenditure accounts of the families of railroad employees. It included witnesses, railroad employees and their families who showed the board from personal experience the impossibility of providing for a family on the wages prevailing before this decision.

The undersigned must dissent from a decision which has ignored these witnesses, the human needs of these tens of thousands of families, which has given them not one word of answer. To them the statement that they are hypothetically 40 per cent or 30 per cent or 20 per cent better off than they were in December, 1917, or in any other period, must sound like a rather bitter jest.

The representative of the shop crafts asked the board to consider the wage question from the point of view of the needs of the families expressed in quantities of food, clothing, fuel, etc. And it appears to the undersigned dissenting members of the board that the basic cause of disagreement lies in the failure to consider this point of view.

In a decision a reduction of 7 cents an hour is impersonal, it

has little to suggest the human side. Consideration of the quantities of food, clothing, etc., which such a reduction will subtract from a family budget will force board members and the public to test the sincerity of their conclusions. And such a test is essential where the pressure of conflicting interests is prone to force a man to take the easiest road out. In dealing with minimum wages the easiest road out may work irreparable harm to hundreds of thousands of persons, many of them children.

The evidence presented by the shop crafts purported to show that the existing wage rates were so inadequate as to force the families dependent upon them to cut down the quantity of food purchased below the level which scientists have determined as necessary to health and full energy. Taking the food budget prepared by Professor Jaffa, of the University of California, for a family of five as a basis, the data presented showed that where 210 pounds per month of meat, fish, milk, eggs, and beans are required, families with an average income of $1,900 per year were able to purchase only 134 pounds; that where 104 pounds of flour, cereals, and rice are required, they could purchase only 80 pounds; and where 160 pounds of potatoes, vegetables, and fruits were required, they were able to purchase only 146 pounds. To summarize the matter, the evidence showed that just and reasonable wages must increase existing rates so as to make good the following monthly food deficits:

	Pounds.
Meat, fish, milk, and eggs	75
Flour, cereal, rice, etc	24
Potatoes, vegetables, and fruits	14
Butter, oils, and fats	6

These deficits are below what Professor Jaffa calls "the danger line below which it is precarious to go."

The Labor Board was created to insure the efficient and uninterrupted use of the transportation system. The shop crafts have cited medical authorities to the effect that steady efficient service is physiologically and psychologically impossible where the bodily needs and normal desires are unsatisfied. Mr. B. Seebohm Rowntree, a well known British authority, writing in the February, 1917, issue of The Nineteenth Century and After, puts the matter forcefully thus:

Now, in pursuing the quest for industrial efficiency, the first problem that meets us is that of the level of wages.

In the course of the discussion he speaks of a bare "physical efficiency wage." In some ways this is a good expression, for it reveals the shortsightedness of those who advocate low wages. It seems to the dissenting members that the fixing of such a wage is mandatory upon the Labor Board, and we can not agree to a decision which falls far short of that standard.

The representatives of the shop crafts offered a quantity budget to show the least amount which would enable them to render the service required for the efficient and economical conduct of the transportation industry. The standard set was frankly not a minimum subsistence standard—it was an economical comfort standard such as a skilled man, with four years of mechanical training behind him, may rightfully expect. The cost of this budget was shown to be approximately $2,600 per year, and provided for a family of five.

In this connection it appears that under Decision No. 147 the skilled railroad mechanic could get only approximately 70 per cent of the supplies and services enumerated. The following comparison between the annual full-time earnings of railroad mechanics under various decisions and the cost of two important minimum comfort budgets shows clearly that the present rates of pay are not justifiable:

Railroad mechanic's earnings for full year compared with cost of necessary supplies.

Annual earnings under present decision	$1,713.60
Annual earnings under Decision No. 147	1,884.96
Annual earnings under Decision No. 2	2,080.80
Cost of United States Department of Labor budget	2,303.96
Cost of railway employees department budget	2,636.97

We are not completely satisfied with the budget which the shop crafts have prepared. In the nature of the case the means for the exhaustive study necessary is not at their disposal. As a matter of fact it was put forward merely as a basis of discussion with the request that the Labor Board and the representatives of management join in the work of establishing such a standard.

Before the Labor Board can establish a just and reasonable basic wage it will have to follow this line, dealing with the needs of the employees. These needs can be scientifically determined within fairly narrow lines. They can be determined from the point of view of the life of the community and from the point of view of the potential working power of the railway personnel.

The failure of the board to deal with this question is but one instance of the more general failure to give thorough consideration to the merits of the case before arriving at a decision.

A JUST WAGE MUST BE A FAMILY WAGE.

In general the majority decision of the Labor Board merely followed the representatives of management in ignoring the whole question raised. Representatives of management have, however, attacked the proposition on one point, that is, the fact that provision is asked for a family of five. Using census figures they found 4.4 persons as the average family instead of 5 and 1.4 dependent children instead of 3. This point has been brought out before the board and almost continuously before the public. In its consideration of the matter the public has, therefore, a right to demand something authoritative.

Mr. B. Seebohm Rowntree is one of the leading authorities. Full consideration of this question of the family will be found in Chapter I of his book entitled *"The Human Needs of Labor,"* which is based upon a thorough study made in New York in 1911. Mr. Rowntree sums up his investigation as follows:

The table on page 32 shows that half the men have had three or more children simultaneously dependent on them for shorter or longer periods. Nearly one-half (46.4 per cent) have three or more dependent children for periods of at least five years. Thus it seems clear that in fixing minimum wages at least three children per family must be allowed for, since no minimum-wage basis could seriously be regarded as satisfactory which for so many years was insufficient for one family out of every two.

Of course employers may argue that they should not have to pay minimum wages, which are based upon transitory needs, during the whole of a workingman's life. If the period of special pressure on the workingman's purse only lasted for a few months, this argument might hold good. But we have seen from the table that 46 per cent of the men have three or more dependent children for five years or more; years, too, which are very critical from the standpoint of the future, since the mother is having children and the framework of their bodies is being built up. Malnutrition lasting over five years of childhood will leave permanent traces on the physique of the next generation. Besides, even if the minimum is in excess of the day-to-day needs, after the exceptional stress is over the surplus will be needed to enable parents to save something toward their old age (pp. 34–35).

Even more important, however, is the proposition of children living in families with three or more dependent children. According to Mr. Rowntree:

An examination of the preceding tables and diagram shows that if we are to base minimum wages on the human needs of families with less than three children, 80 per cent of the children of fathers receiving the bare minimum wage would for a shorter or longer period be inadequately provided for and 72 per cent of them would be in this condition for five years or more. If we allowed for three children per family in fixing minimum wages, 62 per cent would, for varying periods, be inadequately provided for and 54 per cent would be in this condition for five years or more. If we allowed four children per family, 43 per cent of the children would still, for varying periods, be inadequately provided for and 38 per cent would be in that condition for at least five years; and even if we allowed five children per family, 24 per cent of the children would be inadequately provided for and over 20 per cent would be in that condition for five years or more. In view of these facts it will, I think, be clear that any suggestion that minimum wages should be based on less than a standard of three children per family, as some authorities have recommended, is entirely ruled out of court * * * (pp. 40–42).

ENTIRE WAGE-RATE STRUCTURE OUT OF LINE.

It is clear that the majority have failed to consider the real issues involved in the determination of the basic minimum wage and the secondary wages in the transportation industry. The text of the decision gives no evidence of any such consideration. As already pointed out in the dissenting opinion in Decision No. 1028 (maintenance of way employees), the basic wage established in said decision conforms to no existing standard whatsoever. The lowest budgets, those of the National Industrial Conference Board, an employers' organization, could not be met with a wage of less than 50 cents per hour. Nothing less than this should be considered in the industry.

The unjust basic wage throws the whole rate structure out of line. If we conceded the justice of the differential between the machinists' rate and the average rate for unskilled labor under the two decisions, then to obtain a fair level of earnings for machinists that differential of 37 cents must be added to no base less than 50 cents per hour, which would justify a wage rate of at least 87 cents per hour for machinists. As a matter of fact the majority show no grounds upon which a just secondary wage can be determined.

In short, we must dissent from the decision because both the basic wage and the differentials above it appear to have no justification in fact. . . .

JUSTIFICATION OFFERED FOR MAJORITY DECISION.

The majority decision assumes that the rates contained in the decision will be considered low and makes its defense against attack from that angle. In other words, the underlying assumption appears to be that the decision will be regarded in a favorable light by the railroads and the sympathizing business interests, and that it will be regarded in an unfavorable light by those who think of wages in terms of family support. The text of the majority opinion says, in effect, that—

(1) The rates of pay decided upon are not so low as those prevailing in outside industry; and

(2) The classes affected will be better off under the decision than they were in 1920 or in 1917.

The first of these is merely stated as an opinion, and that of the briefest. No facts are cited to justify the opinion. The public is given no basis for understanding the case or forming a judgment.

The second assertion is supported by a few figures which are a misrepresentation of the actual changes in the purchasing power of the wages of this class of employees since the pre-war period.

We must protest against such a cynical disregard of the obligation to inform the public. Aside from the fact that its tendency is completely to vindicate the propaganda of the railroads and consequently to condemn such statements as the employees have been able to bring to public attention, there is the additional fact that the thinness of the justification can not help but create in the public mind a belief that the decisions of the Labor Board do not result from careful consideration of the merits of the case. That such decisions, as that under discussion, carry such an appearance on the face of them appears from the Wall Street Journal's comment upon a similarly written decision from the maintenance of way employees. It said of the decision:

Nothing very exact or scientific is to be found in all this. It means that the Labor Board, like most such bodies, finds itself compelled to function by a process of more or less haphazard compromise. (Wall Street Journal, May 30, 1922.)

The Labor Board has, under the law, a twofold function: (1) To determine upon such just and reasonable wages and working conditions as will render unnecessary a forceful struggle to secure these; and (2) to inform the public in such a way that public opinion may be based upon impartial facts.

We dissent from the majority decision because it conforms to neither of these standards. So important do we consider this misconception of the Board's function that we wish to deal with the true purpose at somewhat greater length subsequently.

CONTRARY TO MAJORITY STATEMENT PURCHASING POWER OF SHOP CRAFTS IS LOWER THAN IN PRE-WAR YEARS.

The outstanding fact about the rates established by the decision is that they mean lower purchasing power and lower standards than employees of the maintenance of equipment forces enjoyed in the pre-war period. This is true not only for mechanics but also for the helper and apprentice group. This seems to be in direct contradiction to the spirit of the opinion expressed in the majority decision that—

> The board is not in sympathy with the idea that a governmental tribunal, empowered to fix a just and reasonable wage for men engaged in serving the public in the transportation industry, should be controlled by the one consideration of the low wages that may be paid to other labor * * *

With such a statement, it is extraordinary that the majority should proceed to base their comparison of relative purchasing power on December, 1917—a period when the wages of these employees were admitted to be materially below those in other industries. How can a decision be justified which does not maintain even the unjust standards of pre-war years?

As in the maintenance of way decision No. 1028, the table showing the relative purchasing power of wages is misleading for two reasons:

(1) Because it deals entirely with hourly rates, ignoring the fact that the number of hours in the regular workday decreased from nine and one-half to eight in the interval. A man's earnings are the product of his regular hours multiplied by his hourly rate. It has been generally recognized as just that a decrease in hours shall not be treated as an increase in pay. A true reflection of the changes in earnings can only be had by considering daily rates; and

(2) Because, as already pointed out, the choice of December, 1917, as a base means the choice of a time when the wages of this class of employees had fallen far behind the cost of living. Railroad executives were unanimous in stating that in December, 1917, the wage rates prevailing on the railroads were materially below those prevailing in other industries. The following quotations from the statement of W. G. McAdoo, former Director General of Railroads, before the Senate Committee on Interstate Commerce, bring this out clearly. He said:

> An absolute essential to the achievement of these imperative needs (relieving the unprecedented congestion of traffic and restoring efficient operation of the railroads) was to satisfactorily dispose of the labor problem.
>
> Railroad employees throughout the country were thoroughly discontented and strikes were impending everywhere.
>
> The railroad executives had testified before the Interstate Commerce Commission and elsewhere that railroad wages were below the scale paid in competitive industries and had been seeking increases in rates in order that they might increase wages.
>
> Railroad labor was grossly underpaid and there were many grave abuses in the matter of working conditions on the railroads which needed correction.
>
> It was clear that railroad employees could not be expected to work for railroads at lower rates of pay than they could command in competitive industries throughout the country.
>
> The high cost of living had made it impossible for many of them to live on the wages they were receiving, and it was clearly in the interest of justice and right, to say nothing of the wisdom and reason of the policy to bring their wages to a level which would enable the railroads to command the requisite amount of service and to prevent the continued depletion of their forces with the constant labor turnover which railroad managers themselves had insisted was one of the reasons why they were unable to make the railroads function efficiently.
>
> Before the Interstate Commerce Commission, in March, 1917, President Underwood of the Erie, President Samuel Rea of the Pennsylvania, President Smith of the New York Central, and several other railroad executives complained that the low wages being paid workers were driving thousands of men out of railroad service and preventing the efficient operation of the railroads.

He further testified that—

> The fact is that railroad employees worked for less pay during the war than any other class of industrial workers doing similar work. The further fact is that no fair complaint can be made of

the part the railroad employees performed during the war. The realization that they were working for their Government in the stress and strain of war, that their patriotic service was essential to victory, and that they would be fairly treated, inspired and spurred them to unusual effort and to faithful service.

Examination of the following tables will show clearly the extent to which the railroad shop employees have fallen behind throughout the course of the inflation and deflation periods:

TABLE 1.—*Average daily rates.*

Class of employees.	*December, 1915.*	*December, 1917.*	*January, 1920.*	*May, 1920.*	*July, 1921.*	*Under present decision.*
Machinists	4.18	4.80	5.78	6.82	6.18	5.62
Boiler makers	4.10	4.71	5.85	6.89	6.25	5.69
Blacksmiths	4.37	4.95	5.88	6.92	6.28	5.72
Sheet-metal workers	3.91	4.40	5.77	6.81	6.17	5.61
Electrical workers	4.34	4.37	5.71	6.75	6.11	5.35
Carmen	3.05	3.58	5.44	6.48	5.84	5.15
Molders	4.40	4.88	5.76	6.80	6.16	5.60
Helpers and apprentices	2.37	2.77	3.85	4.89	4.25	3.67

TABLE 2.—*Percentage increase in daily rates.*

Class of employees.	*December, 1917, over December, 1915.*	*January, 1920, over December, 1915.*	*May, 1920, over December, 1915.*	*July, 1921, over December, 1915.*	*Present decision over December, 1915.*
Machinists	14.8	38.3	63.2	47.8	34.5
Boiler makers	14.9	42.7	68.1	52.4	38.8
Blacksmiths	13.3	34.6	58.4	43.7	30.9
Sheet-metal workers	12.5	47.6	74.2	57.8	43.5
Electrical workers	6.7	31.6	55.5	40.8	27.9
Carmen	17.4	78.4	112.5	91.5	68.9
Molders	10.9	30.9	54.5	40.0	27.3
Helpers and apprentices	17.9	62.5	106.3	79.5	54.8
Per cent increases in cost of living	35.5	89.6	106.0	71.6	58.8

TABLE 3.—*Per cent decrease in purchasing power.*

[Subsequent dates compared with December, 1915.]

Class of employees.	*December, 1917.*	*January, 1920.*	*May, 1920.*	*July, 1921.*	*Present decision.*
Machinists	15.3	27.1	20.8	13.9	15.3
Boiler makers	15.2	24.7	18.4	11.2	12.6
Blacksmiths	16.4	29.0	23.1	16.3	17.6
Sheet-metal workers	17.0	22.2	15.4	8.0	9.6
Electrical workers	25.7	30.6	24.5	17.9	19.5
Carmen	13.4	5.9	[1] 3.2	[1] 11.6	[1] 6.4
Molders	18.2	31.0	25.0	18.4	19.8
Helpers and apprentices	13.0	14.3	[1] 0.3	[1] 4.6	2.5

[1] Increase.

From this table it appears that since 1917 the employees covered by this decision have almost without exception fallen short of receiving enough to enable them to maintain pre-war standards. The only exceptions are the carmen and the helpers, which classes have just about maintained their level. Under this decision the unjust level of earnings described by Mr. McAdoo and by numerous railways executives as prevailing in 1917 will be perpetuated.

These figures appear in strong contrast to the misleading table in which the majority attempt to show that the present decision will mean increased purchasing power ranging from 18.8 to 45.7 per cent above that of December, 1917. It seems to the dissenting members of the board that the public has a right to demand a true picture of the grounds on which important decisions rest.

WAGE LOSSES TO RAILROAD EMPLOYEES.

The following table shows the total decrease in the returns to the maintenance of equipment employees as a result of decisions and reductions in force. In this table each figure is based upon the number of employees of each class employed in the month when the decision became effective. This conservative method is adopted so as to avoid duplication in consideration of the lay-offs.

Shop crafts.

Saving to carriers by Decision No. 147	$64,379,872
Saving to carriers by Decision No. 222	38,879,976
Saving to carriers by present decision	59,374,546
Saving to carriers by reductions in force	164,252,379
Total saving at expense of shop forces	326,886,773

The actual wage reductions per annum resulting from the Labor Board Decisions Nos. 147, 222, and this decision, based on the number of shop employees in the service of the carriers as of December, 1917, are as follows:

Decision No. 147	$89,850,015
This decision	78,835,626
	168,685,641
Decision No. 222 (approximated by board's statistical staff)	38,879,976
Total of wage and rules decisions	207,565,617
Reduced pay roll resulting from reductions in force	164,252,379
Total loss to shop forces	371,817,996

It is estimated that the recent rate cut advised by the Interstate Commerce Commission will mean a reduction in operating revenue of approximately $225,000,000 in addition to the $200,000,000 in cuts for which the carriers have already claimed credit. From the above table it appears that the reductions in the pay roll of the maintenance of equipment forces alone are greater than the whole of the new rate cut.

Following the same method, it appears that the carriers have cut the pay roll of the maintenance of way employees to the extent of at least $275,237,160, as follows:

Saving to carriers by Decision No. 147	$104,538,169
Saving to carriers by present decision	51,021,755
Saving to carriers by reductions in force	113,624,972
Saving to carriers by Decision No. 501	6,052,264
	275,237,160

The actual wage reductions per annum resulting from the board's Decisions Nos. 147, 501, and this decision, based on the number of maintenance of way employees in the service as of December, 1917, are as follows:

Decision No. 147	$127,280,418
This decision	68,846,181
Decision No. 501 (approximated by board's statistical staff)	6,052,264
Total of wage and rules decision	202,178,863
Reduced pay roll resulting from reductions in force	113,624,972
Total loss to maintenance of way forces	315,803,835

In connection with these figures it should be stated that the reductions in force are not based on the low figures of February, 1922,

but on the summer force of 1921, during which year, according to the opinion of the Interstate Commerce Commission (reduced rates 1922, No. 13293) the maintenance work was very nearly up to average.

The savings from the other classes as a result of Decision No. 147 totaled approximately $150,000,000. Without considering the savings at the expense of these employees through reductions in force, the total amount shown above as given up by the employees as a group exceeds $750,000,000. This is far in excess of any benefits transmitted to the public in reduced transportation rates.

The above calculation is an attempt to appraise the saving which will accrue to the carriers even under normal traffic conditions. The slash in the pay rolls resulting from the subnormal traffic of 1921 is far larger. It can be shown most clearly by comparing the total pay roll for the latter half of 1920 with that for the same period of 1921, as follows:

Pay roll for the last six months of 1920	$2,034,716,238
Pay roll for the last six months of 1921	1,343,886,463
Decrease for half year	690,829,775

In other words, the pay-roll saving is running at an annual rate of $1,300,000,000.

This decrease in the pay roll appears in such strong contrast to the increasing prosperity of the carriers that it should not pass without comment. The carriers which received enormous increases in operating revenue specifically to cover increases in pay roll are failing to afford the public corresponding decreases when the increases granted to employees are taken away.

The average net income received by the railroad corporations since 1916 has been larger than ever before in history. Including the Government standard return, during the years when railroad employees' wages were falling short of meeting the rising cost of living, the net income of the carriers was running over $900,000,000 annually. Even in the year of severest depression the net income totaled half a billion dollars. . . .

EFFECT UPON THE MORALE OF THE EMPLOYEES.

The significance of this very apparent contrast between the upward tendency of profits and the downward tendency of human

living standards among wage earners will be felt in a lowering of industrial morale which will prove a handicap far exceeding any apparent gain from decreased pay rolls. This is pointed out by Mr. Sumner H. Slichter in an article on Industrial Morale, published in the Quarterly Journal of Economics. Mr. Slichter, who is an authority on the subject, says:

> Most important of all in creating the prevailing low state of industrial morale is the workmen's conception of the relationship prevailing between themselves and industry—the feeling on the part of wage earners that instead of industry being conducted for their benefit as well as the benefit of the stockholders, it is devoted almost exclusively to advancing the interests of the stockholders, and that instead of workmen being a part of industry and insiders in it, they are outsiders whom industry is not interested in serving, but from whom it is interested in getting all it can. * * *
>
> Consider the effect of the workman's conception of industry and its relation to him upon industrial morale. What could be better calculated to destroy his sense of obligation toward the enterprise by which he is employed and his willingness to cooperate to make it successful and to promote its prosperity than the feeling that it is seeking to dominate and use him rather than to serve him, that it is working against him rather than for him, that it is seeking to pay him as little as it finds necessary, to prevent his wages from going any higher than it can help, to keep his working day at as many hours as possible, and to get more and more out of him by pushing up the speed of his work? If one party to an arrangement seeks to give as little and get as much as possible, is it not natural for the other party to do likewise? No one would expect a workman who feels that his employer pays the bare minimum which economic conditions compel him to pay to reciprocate by doing his best to promote the interest of his employers * * * . When industry seeks to keep wages low and hours long, when it consistently resists the workmen's efforts to raise their standard of life, workmen can not be expected to be interested in helping to make profits large. (Quarterly Journal of Economics, Vol. XXXV, pp. 54–56.)

The decision of the majority will result in lowered morale among the workers in the transportation industry. This is inevitable. The results of a similar policy are already being felt in the scarcity of labor in the steel industry. This is pointed out by a special writer for the Chicago Tribune which editorializes the matter. The correspondent speaks of men in the Calumet region who "after working a day or two at 30 cents an hour," thus coming within the rates set by the majority for section men, "skipped from

the steel mills to other manufacturing plants where higher wages were paid." Others are quoted as saying that "the wage rates were equal to working for nothing, as living expenses ate up the pay envelope and still had some appetite left." As a matter of fact, labor has been over-deflated. The necessity of an impartial regulatory authority in the face of this situation is expressed by Justice Higgins as follows:

> There is very real antinomy in the wage system between profits and humanity. The law of profits prescribes greater receipts and less expenditure—including expenditure on wages and on the protection of human life from deterioration. Humanity forbids that reduction of expenditure should be obtained on such lines. Other things being equal, the more wages the less profits; the less wages, the more profits. It is folly not to admit the fact and face it. Moreover, the economies which are the easiest to adopt in expenditure tend to the waste and degradation of human life—the most valuable thing in the world; therefore, so long as the wage system continues, there is need of some impartial regulating authority. (Harvard Law Review, Vol. XXXII, No. 3, p. 216.)

The attitude which the Labor Board should have taken in the present subnormal industrial situation is obvious. Its function is to prevent the waste and degradation of human life.

PROPER FUNCTION OF RAILROAD LABOR BOARD.

The Interstate Commerce Commission in its recently issued opinion urging reduction of transportation rates introduces its "conclusion" with a very terse statement of its function. This statement may be held to define the function of any Governmental regulatory body. The Commission says:

> The carriers take the position that we must be guided solely by those things which are definite and certain in the past. With this we can not agree. Our function under the law is not that of mere computers and can not thus be atrophied. The duty to prescribe rates for the future carries with it the obligation to exercise an informed judgment upon all pertinent facts, present and past, in order to forecast the future as best we may. (*Report on Reduced Rates*, 1922, p. 730.)

In their public presentations the carriers have taken the position that the Railroad Labor Board must be guided solely by those things which are definite and certain in the past. In other words, they have asked the board to perpetuate the standards or lack of

standards prevailing in the unregulated labor market of pre-war years. In short, they want the Labor Board to write decisions guided by the injustice of a struggle between employers and employees in which right is determined by might. That this can not be the function of the Labor Board under the transportation act is apparent to anyone who reads its provisions. President Daniel Willard, of the Baltimore & Ohio Railroad Company, has stated this concisely, as follows:

> In fact, Congress in the transportation act has created for this particular purpose a special labor court consisting of the same number as the Supreme Court of the United States appointed in the same way—that is to say, by the President and confirmed by the Senate—and has given the board or court a status and dignity in keeping with its importance. The law says that it shall be the duty of the board to establish rates of pay and standards of working conditions which, in the opinion of the board, shall be just and reasonable.
>
> It may, indeed, be said that Congress by this act has made a preferred class of the railroad workers, because, so far as I know, this is the first and only time that Congress has ever definitely said that any particular class of people should be given at all times and under all circumstances just and reasonable wages and working conditions.
>
> Of course, Congress did not do this primarily in the interest of the workers; Congress acted only as it had a right to act in the interest of the nation as a whole. Congress provided or aimed to provide by law so that the railroad workers would at all times be assured of just as good wages and just as good working conditions without striking as they could reasonably expect to secure if they did strike, for it is clear that no one could justify or expect to win a strike for wages or working conditions that would be unjust and unreasonable. (Railway Review, April 2, 1921, p. 521.)

Justice Higgins, of the Australian Court of Conciliation and Arbitration, in discussing the function of that court, states the matter in much the same terms, though more tersely, as follows:

> The people are consumers as well as producers and the object of the power of the constitution is primarily to protect the people as consumers and, as incidental to that end, to provide means whereby producers can have their legitimate human needs satisfied without recourse to stoppages. (Harvard Law Review, Vol. XXXII, p. 205.)

Such industrial courts are a comparatively recent development in government, and Justice Higgins has taken the lead in ex-

pressing the theory on which they rest, the function which ties them to the social fabric. He sees this development as a new province for law and order. He sees it as the function of such a court to introduce system and standards into the use of human life for industrial processes.

A. O. WHARTON.
ALBERT PHILLIPS.
W. L. MCMENIMEN.

2. THE SHOPMEN'S STRIKE—A SERIES OF BLUNDERS [1]

Experience is the best teacher. Some people welcome its lessons when it shows they have been right but reject its lessons when it shows they have been wrong. Progress is due to those who are willing to learn from experience, as well as other teachers, even when the teachers show they have been wrong.

The shopmen's strike, which has now been settled on some railways, has afforded an experience which should teach some most important and valuable lessons to railway managers, railway labor leaders and railway employees. The future experience of the railways which have settled and are taking the strikers back and those which have not settled will afford some additional lessons.

The strike has been terribly costly to the railways, the strikers and the public. The issuance of the original order for it and its continuance so long have been due to a series of big blunders. But all the blunders have not been committed by the labor leaders and the members of the unions. Every party concerned has blundered. Some things which when done seemed obviously wise and beneficial to those who did them now appear in an entirely different light.

One of the worst blunders of the series that has caused and protracted the strike was that made by the railways which adopted the policy of contracting out work which it had been customary to do themselves. They saved money by it for a time, and it seemed to their managers wise and proper. It was done by only a small part of the railways but it has had important consequences for all of them. It exasperated and alarmed labor leaders and employees to an extent that few people realized until recently. The labor leaders and the employees feared that the system of contracting would be extended to all the railways of the country, with the

[1] From *Railway Age*, vol. 73, pp. 550–551 (September 23, 1922). Reproduced by permission.

result of breaking down all the working conditions and wages favorable to labor that had been approved by the Labor Board. There is no doubt now that the policy of contracting out work contributed largely toward causing the strike. In addition it gave the labor leaders a pretext for charging that the railways had violated, or at least evaded, the law and the decisions of the board on a wholesale scale, and for using this charge in defense of the employees' action in striking against the decisions of the Labor Board. It is wholly inconsistent for spokesmen of the railways to denounce employees for striking against decisions of the Labor Board when railways themselves are doing virtually the same thing.

The next blunder was committed by the labor leaders when they issued the strike order. They knew they could get rehearings by the Labor Board in the wage cases at any time. They should have known that public sentiment and the sentiment of many members of their own organizations would be against a strike which was in defiance of decisions of the Labor Board that had been reached after full hearing of all the matters in controversy.

The next blunder was made by the Labor Board in immediately issuing statements that the strikers had sacrificed their seniority rights, and by many railways in issuing notices that unless the strikers returned to work within a very few days their seniority rights would be forfeited. These announcements and ultimatums immediately became a bar to an early settlement of the strike. It was unreasonable to expect that men who had struck would return to work within a few days. Some roads which gave the strikers two weeks, or even more, within which to return to work got back many of their men before the time limit expired. If the seniority issue had not arisen as a result of so many railways prematurely depriving the strikers of opportunity to return to work with their rights unimpaired the strike would have been ended within three weeks.

The next blunder was made by President Harding when, after the strike had been going on for some time, he proposed that it should be terminated by the railways taking the strikers back with their seniority rights unimpaired. This encouraged the strikers to stay out in the hope that a settlement finally would be made which would restore their seniority rights after the railways had committed themselves so far to the men at work that they could not honorably or with any regard for future consequences take the strikers back with their seniority rights.

The result of these and other blunders has been a strike which lasted ten weeks on the railways which have settled, which is still continuing on most of the railways, which has cost employees, railways and the public hundreds of millions of dollars and the effects of which will cost hundreds of millions in future. It has had and will have some good effects. It has broken down the plan of national negotiations and settlements by which the labor unions had imposed uniform working conditions and wages on all the railways, and by which they were determined to maintain them. It has disillusioned many thousands of railway employees who had been led to believe that the railways could not or would not long resist a nation wide strike and that they had more to gain by striking than by accepting the decisions of the Railroad Labor Board. But the net result is to demonstrate what every sane man should have conceded before it occurred—namely, that the railways and their employees have more to gain by dealing with each other fairly and reasonably and by accepting and carrying out decisions of the Railroad Labor Board regarding controversies that they cannot settle themselves than they have to gain by fighting their differences out in strikes.

A strike, like a war, is a game in which usually everybody concerned loses. What the shop employees and the public have lost is fairly obvious. Even railways which have won the strike have suffered losses which they will feel for years. The strike should cause the leaders in the railway field, in the labor field and in public life to join in good faith in an effort to devise and carry out measures which will prevent similar struggles in future. This is what would be done if the wishes and counsel of the moderate men of all interests should prevail. Unfortunately the extremists connected with the various interests are as influential as the moderate men, and labor leaders whose real goal is the destruction of private ownership, railway leaders whose real desire is the destruction of labor unions and politicians whose sole object is the promotion of their own selfish ambitions will exert as much influence on the final outcome as the moderate men.

3. Strikes [1]

The Tennessee mountaineer ordinarily has a feeling of indifference, sometimes approaching antipathy, for his brother in black,

[1] From Ben W. Hooper, *Saturday Evening Post*, vol. 195, pp. 6–7, 104, 106 (October 14, 1922). Reproduced by permission of the author and publisher. Mr. Hooper is chairman of the United States Railroad Labor Board.—Ed.

who reciprocates by regarding mountain people as po' white folks. In a mountain courthouse the trial of a lawsuit had been commenced, in which a negro was suing a railroad for damages. A lank highlander was called forward to undergo the preliminary test of his eligibility to serve on the jury.

"Have you formed or expressed any opinion as to the merits of this case?" asked counsel.

"Nary bit," responded the prospective juror.

"Got any feeling or prejudice in the case?" persisted counsel.

"Gosh, no," answered the witness with a surprised look on his face. "Couldn't have—nigger on one side and railroad on the other."

This popular feeling of antagonism to the railroads had prevailed throughout our country for almost half a century. To what relative extent it was attributable to the speculative excesses of the early promotion period, to the activities of railroad lobbies around state legislatures, to the accumulated individual grievances of the citizenry in each community, to the alleged misdeeds of the financial manipulators of railway securities, to the demagogical propaganda of railroad-baiting politicians and to the instinctive suspicion of the common citizen toward all great corporations is not material to the present purpose. The outstanding fact is that until recently the average man had felt no personal concern about the railroads. Their power, prosperity, future extension and continued adequacy had been taken as matters of course. Not much thought had been given to the fact that railway transportation is not merely an incident to the development of this country, but that it is the basic cause—the why of the United States of America. To be sure, the Caucasian race would have built a nation on this continent even without railways, but try to conjure up in your imagination what sort of nation it would have been, with its fringe of civilization along the seaboards, and its vast continental interior, composed of disconnected primitive communities, socially and industrially Asiatic. But the public viewpoint has undergone a change. All of a sudden the great war, that rude awakener of sleeping forces, jarred into consciousness the smug indifference of the masses toward the railroads. Having first learned the lesson of the indispensability of the railways to national military success, the people are now giving heed to the fact that this is the one industry of all industries that cuts a figure in the daily life, the comfort, the health, wealth and well-being of every individual in America.

When President Wilson and Congress got ready to terminate Federal control of the railways and hand them back to private ownership they keenly realized that purely financial considerations were not the only ones that had to be dealt with. The interests of stockholders and bondholders, the adjustments between the Government and the owners involved complex and difficult questions, but they were largely technical and mathematical.

The most delicate question was the human one of the readjustment to a peace basis of labor conditions on the railways. This involved the handling of two million men, highly organized, and at that time quite generally restless and discontented. . . .

Contrary to the prevalent public understanding the wages of railway employes during the war did not increase by so great a ratio as did the compensation of labor in other industries. This was especially true of the more skilled classes of employes. The upward readjustment of railway wages had been promised for some time prior to the termination of Federal control. It is also pertinent to recall in this connection that the cost of living continued to mount after the end of government control, March 1, 1920, until the apex was reached June 1 of that year.

Though the railroad employes were dissatisfied at that time with their wages they were pleased, generally speaking, with the rules and working conditions that the Railroad Administration had conceded to them. On the other hand, the railway managements were correspondingly displeased with many of these new rules and working conditions, which they characterized as impracticable and uneconomic, and under which they declared successful and satisfactory operation to be impossible.

This condensed résumé of railway conditions, at the resumption of private operation, should serve to convince even the casual student of industrial problems that the situation contained sufficent inflammables for many gorgeous bonfires. . . .

To grapple with this railroad-labor situation the Transportation Act provided for the establishment of the Railroad Labor Board, to be composed of nine members—three representatives of the railroads, three of the employes and three of the public. Upon the desks in front of this board was immediately dumped practically every form of dispute that had ever arisen between railroads and their employes, affecting both the rules and wages of all classes of workers. No new tribunal ever began its existence with such a congested docket.

The labor article of the Transportation Act was a piece of pioneering legislation. Its main purpose was to prevent interruptions of traffic arising from railroad-labor controversies. The helpless public had been harassed by periodic strikes of railway employes for a generation past. These strikes had not been nation-wide, affecting all carriers and all sections of the country simultaneously, and comprehending all classes of railway employes. They had usually involved one class of employes at a time and one or a limited number of railroads. Nevertheless, they had cost the carriers, the employes and the general public directly hundreds of millions of dollars, and indirectly a great deal more.

Congress therefore reasoned that if such enormous losses had been sustained from strikes involving only a part of the roads, a fraction of the employes and a limited territory, and that in normal times and with labor organizations comparatively weak and incomplete, it would be the part of wisdom to try to avoid the catastrophe of strikes of national scope, carried on by railway employes fully organized, in the period of depression and readjustment inevitably sequent to the war.

The method devised by Congress and embraced in the Transportation Act for the adjustment of railroad-labor disputes was a strange combination of strength and weakness. It contained mandatory requirements that the carriers and the employes should endeavor, in conference, to settle all disputes, and failing to reach an agreement should submit the controversy to the Railroad Labor Board. It provided that the board should hear and decide all such disputes, but it did not provide any means or method for the enforcement of the board's decisions other than the right conferred upon the board to make public the fact that either party had violated a given decision.

Here was a new experiment in American legislation, a law without the sanction of a penalty, a tribunal required to pass upon questions involving hundreds of millions of dollars and the precious rights of millions of men, leaving to both parties absolute unfettered freedom to violate the final decision and to visit upon the whole nation the grievous results of such violation. It was expected that the board should make its decisions so obviously "just and reasonable" that they would be voluntarily accepted by both parties. It was apparently not in the contemplation of Congress that one or both of the parties themselves might occasionally become unjust and unreasonable. Not only was the board

given no powers of compulsion but very properly it was not vested with powers of mediation. It can decide, but cannot compromise. . . .

At a first glance this plan would appear to the sophisticated judgment of any man on the street as a pipe dream. His knowledge of the proclivity of mankind to violate any and all laws, even at the peril of fine, imprisonment and the noose, would bring from him the quick opinion that the decisions of the Labor Board would be uniformly ignored by the loser and respected only by the winner.

There were, however, psychological and economic factors lying just underneath the surface of things that made this idea less fantastic than it was held to be by the casual appraisal of the sophisticated citizen aforesaid. One of these was the fact that such a board would afford both the carriers and the employes a battleground upon which to conduct their industrial struggles—in the vernacular, a place where they could get their troubles off their chests. Instead of being compelled to deadlock across a conference table and ultimately, in some instances, to fight out their differences in strikes and lockouts when they did not really want to fight, the labor board would furnish the disputants a decisive method for terminating controversies. The habit of acquiescing in the board's decision of questions of minor importance would naturally extend to the observance of the board's judgments in many cases of more vital concern, where otherwise strikes would have resulted. It will be remembered that in days gone by many strikes were justified by the assertion that there was no place to take the dispute and nothing to do but strike. It was also believed that both parties would often consider it of great financial advantage to escape the burdens and losses of a strike when it could be done honorably and where the matter at stake was not too great. In connection with the foregoing considerations it was always assumed that the labor board would be so fairly and impartially constituted as to command a reasonable degree of confidence from both sides. In addition to all these things there was ground for the belief that public opinion would, in fact, exert a powerful influence on both the carriers and the employes, as it would be a grave tactical blunder for either party to run counter to a positive and well-defined public sentiment.

It is safe to say, however, that though Congress felt that the force of public opinion would usually make effective the board's decisions, occasions would arise when self-interest would tempt

both parties to rebel. This very natural and logical conclusion caused the Senate to incorporate in the bill as it passed that body a provision for the punishment of violations of the board's decisions by either the roads or the men.

There was a mild antistrike clause, forbidding the concerted walkout or the strike, but expressly recognizing the right of the individual to leave the service at any time. This provision was eliminated by the House in response to the vigorous insistence of the labor organizations. In fact, the railway employes strenuously resisted the enactment of the law even without the antistrike provision, on the theory that its requirements measurably restricted their right to strike.

It must be said to the credit of the labor organizations that, notwithstanding their opposition to the passage of the Transportation Act, they immediately perfected their machinery for the submission of cases before the board, and have continued to compile data and make most painstaking and elaborate presentation of their contentions.

During the two and one-half years that have elapsed since the Railroad Labor Board came into existence it has disposed of 8417 questions brought to it by the carriers and the employes. Of these, 7727 have been disputes formally docketed, heard and decided. Among them were the disputes comprised in three general readjustments of wages and the revision of rules, applicable to all the railroads and the various classes of the employes.

This great volume of work done by the board may prove its energy and industry, but the question of practical interest to the public is: To what extent has it accomplished the paramount purpose for which it was created—namely, the prevention of strikes that interrupt commerce?

Leaving out of consideration the so-called outlaw switchmen's strike which was under headway before the board was organized April, 1920, two strike situations have so far confronted the board. In October, 1921 all the sixteen major railway-labor organizations, comprising the Train and Engine Men, the Switchmen, the six Shop Crafts, the Clerks, Telegraphers, Maintenance-of-Way employes and the smaller organizations, voted to strike in protest against the wage reduction of July first, previous. This threatened strike was averted by members of the board by the exercise of extra-official methods of conciliation at the last minute. . . .

After this disturbance had cleared away, labor conditions on the railroads remained quiet until the spring of 1922. It will be observed that the board had functioned for more than two years without a strike of any magnitude.

Beginning May twenty-fifth a series of decisions reducing the wages of several classes of employes was issued, effective July first. Following these decisions the Federated Shop Crafts, the Maintenance-of-Way, the Stationary Firemen and Oilers, the Signalmen, and on some roads the Clerks, put out strike ballots. In all cases except that of the Shop Crafts the vote was taken on the one question of accepting the wage reduction. The shopmen submitted to a vote of their membership three distinct questions, namely:

The contracting of certain carriers' shops to be operated by so-called independent contractors;

The board's recent wage reduction;

Seven of the rules handed down by the board in the latter part of 1921, and accepted by the men under formal protest.

The system of contracting railroad shops had rapidly spread to a considerable number of carriers. With variations in detail it usually took the form of handing over to an outside contractor the shops of a road, with all their machinery, tools and equipment, with all necessary material and supplies for the shop work to be furnished by the carrier and with the agreement to pay the contractor a certain per cent of the amount of the pay roll as a consideration for his operation of the shops. Some of these contracts were made with men who had enjoyed little or no experience in shop work or with men who until quite recently had been employed as officials of the carriers. The carriers, of course, continued to maintain elaborate supervision of the work. The theory underlying this system was that the shopmen ceased to be employes of the carrier and became employes of the contractor, and were therefore no longer under the jurisdiction of the Labor Board. This legal metamorphosis left the men doing the same railroad work as before, but their wages and working rules were now arbitrarily fixed by the contractor. The rules and wages, which had cost their organizations years of effort and great financial expenditure to build up and establish and which had been sanctioned in their existing form by the Railroad Labor Board, were swept away by this feat of legerdemain. At the same time if these men were, in fact, removed from under the Transportation Act, where Con-

gress had placed them, the public was deprived of whatever efficacy the act contained for the prevention of strikes, and by the extension of this practice all employes could be taken from under the jurisdiction of the board.

This situation was a very irritating one to the employes of this class, as well as to others to which it was applied. It originated in the desire of certain carriers to reduce wages more rapidly and to make more drastic changes in the rules than the board had deemed wise and proper. At the time the strike ballot was taken there were seventeen roads that had contracted all or a part of their shop work. Of course the roads strongly insisted on their legal right to enter into such contracts and pointed to the undisputed fact that this practice had obtained to some extent for many years prior to the enactment of the Transportation Act. This view, however, failed to take into account the important fact that a thing might have been perfectly permissible before the Transportation Act, but not afterwards.

The Labor Board in its decisions on these contract disputes held that the carriers might enter into such contracts if they desired, but that the contractor would be regarded by the board merely as an agent of the carrier, and the shopmen would still be employes of the carriers, subject to the provisions of the Transportation Act and the decisions of the board.

When the strike vote had been taken the board, following a precedent set in the case of the train and engine service organizations last fall, cited the carriers and the organizations of employes about to strike to appear before it June 30. In form this citation was for the purpose of conducting the statutory inquiry as to whether the board's decisions had been violated, but in fact it was mainly for the purpose of bringing all parties face to face before the board in a final effort to find means of averting the strike.

Just as the board was convening it received a letter from the head of the Shop Crafts, declining to appear. The president of the Stationary Firemen and Oilers pursued the same course. Subpœnas were issued for both, but the president of the Shop Crafts could not be found. He assigned as the reason for his absence the fact that the strike order was being sent out, and that his attendance would create uncertainty and confusion among the shopmen, which might result in disorder. . . .

As the hearing progressed the railway executives whose roads had been contracting shop work were called upon to declare their

purpose as to the observance of the board's decisions in the contract cases, and all but two of them agreed to abandon the contracts and conform to the decisions of the board. This unquestionably helped to clear the atmosphere.

The representatives of the Brotherhood of Maintenance-of-Way Employes and of the Signalmen attended the hearing. The examination of the respective heads of these organizations created a somewhat better feeling, and a few days later the president of the Maintenance-of-Way Brotherhood and his committee met members of the board, and after a very full discussion of their troubles and grievances the organization decided to remain within the limits of the law and to resubmit the question of wages and of certain rules to the board.

Soon afterward the president and the committee of the Signalmen held a similar meeting and discussion with members of the board and announced their adoption of the same policy.

On July first, the day following the strike hearing, the strike order became effective and the shopmen struck on all the two hundred and one Class I railroads in the United States.

When the strike was less than two weeks old the leaders of the six Shop Crafts signified to the chairman of the Labor Board, after several conciliatory conferences, their willingness to have the men return to work and to ask for a rehearing by the Labor Board of the wage and rule decisions against which they had struck, but this offer was conditioned on the reinstatement of the strikers with their seniority rights unimpaired. This condition was rejected by the carriers on the ground that it would be a violation of the rights of the employes who had remained in the service and of the new men who had just entered the employ of the roads. Thus it came about that every question upon which the men had gone out could be adjusted by means that would have been as easily available before they went out as afterward. Having needlessly gone out, the only question left to wrangle about was how to get back in: Around this point the battle raged for weeks. It was the subject of mediation, conference and even Presidential proclamation. This question of seniority, of which not one man in a hundred had ever heard before, became a breakfast, lunch and dinner topic all over the United States. It was the subject of editorials, the text of sermons, and the inspiration of thousands of wordy whereases and resounding resolves. Although there were some who pronounced it a false issue and condemned the obstinacy

of both parties for haggling about it while the consumer cried for coal and cantaloupes, it really involved a most vital question. That question was: Does the railway employe who goes out on a strike carry with him a vested right in his job and the benefits and privileges incident to it?

The striking shopmen answered in the affirmative and gave reasons that might be analyzed as follows:

The striker has not ceased to be an employe of the road, but has merely suspended work. He has assumed a status analogous to that of an employe on furlough, who, when he is recalled, resumes his former position on the seniority roster;

He had the right to suspend work in concert with his fellows—in other words to strike—because the law recognizes his right to strike. In this particular instance he has not violated the Transportation Act, not even the objectionable decisions of the Railroad Labor Board, for in the exercise of the right given him by the act he had not accepted those decisions;

If the men lost the strike and were never taken back in a body. the worker who returned individually could not claim his former position and the rights incident to it, but if the strike was won or settled and the men returned as a body they were entitled to the restoration of their positions and their places on the seniority roster.

The fact was pointed to that in many previous strikes the returning men had been accorded their former places with seniority. . . .

Analyzing in the same way the contentions of the railway executives, they were as follows:

Conceding that the employes had the right to strike, when they exercised that right they ceased to be employes. There is no similarity between the status of a striker and a man on furlough. The rules provide for furloughs and for the preservation of a man's seniority rights during the period of a furlough;

It was the undisputed right and duty of the carriers to employ men in the place of those who had struck, in order that they might discharge their legal and moral obligation to the public to maintain efficient and uninterrupted transportation;

It being the right and duty of the roads to employ men in the places of the strikers, the men so employed were rightful and legal employes of the roads, entitled to all the rights and privileges inuring to railway shopmen under the Transportation Act and

the code of rules established in accordance with it. These rules are expressly applicable to all the shop employes of a road, both union and nonunion, and they automatically apply to every new employe the minute he enters the service. Among these rules are those governing seniority. There is nothing in the rules or in the law that establishes the absurdity that a man may abandon his job or position, and at the same time retain any of the rights or perquisites incident to it;

Though it is true that in some strikes the men have been reinstated, this has been done by agreement or compromise between the parties and not as a matter of right in accordance with existing rules.

The President's first recommendation that the strikers be reinstated with seniority was such a compromise proposal, not purporting to reflect his views as to the principle involved in the seniority controversy; but his second recommendation suggested a course in strict conformity with the law and the rules—namely, that the seniority question be submitted to the Labor Board for decision.

From the foregoing synopsis of the respective lines of argument it is evident that the point in issue is one of deep significance both to the carriers and to the labor organizations, not only in its bearing on the present strike but in the handling of future labor troubles.

As this is written the shopmen's strike is still in progress, and thoughtful people are now taking an inventory of the entire railway-labor question, with a view to possible legislation at next winter's session of Congress. That there will be an avalanche of bills of infinite variety is already assured. The question, in the meantime, will have provoked some thought and much oratory in connection with the Congressional campaign. . . .

In this discussion there are two fundamental facts that will admit of no difference of opinion. The first is that the railway employes by a general strike involving all or the major organizations, as was threatened in the fall of 1921, can tie up, hard and fast, all the railroads in this country, from boundary to boundary, any time they see fit. All this outburst of conversation that occurs about once a year in regard to running the trains with soldiers is mere vocal exercise. Soldiers can guard trains admirably, but there are very few of them that could operate a train.

We have had a demonstration of what the shop crafts alone can do to choke transportation. Here is a class of employes that the general public knew so little about that they were hardly regarded as railroad men. Really the train and engine men, the engineers, firemen, conductors, brakemen and switchmen are the only railroad employes that the public in general considers indispensable to the operation of the railways. It is true that the men who roll the wheels are of first importance in the operation of the trains, but there are other classes of employes, who perform work of a less conspicuous nature, that are essential to the maintenance of traffic. Dispatchers and telegraphers, mechanics, clerks, signalmen, maintenance-of-way employes and others contribute to the safety and efficiency of the modern railroad.

In case of a general strike comprising all classes of railway employes, what chance would there be to recruit a new force, competent in skill and adequate in numbers to keep traffic going? Absolutely none within any reasonable length of time. Enough competent men could be found to operate a few trains, but the traffic and travel that could be handled under such conditions would not be a drop in the bucket. Not only can the railway-labor organizations close down the roads but they can keep them shut down with practical completeness for a long period of time. The public might as well pigeonhole that fact now for convenient reference as go through the process of reacquiring it at enormous cost later on.

To this first proposition let a second be added of equal indisputability. A discontinuance of railway operations in the United States would bring upon the people instantaneous suffering and loss that would be extended and accelerated by each passing day, until it had developed into the most overwhelming domestic catastrophe that ever befell our nation. Such a strike would be a greater economic disaster than was the War Between the States, and it is within the range of possibilities that it would cost almost if not quite as many lives. It is not worth while to attempt to enumerate and describe in detail the inevitable results of a universal railroad strike. The rotting of fruits and vegetables in the fields, the denial of shipment to grain, livestock and other foodstuffs, the shutting down of mines and factories, the unemployment of unprecedented millions of people, the cutting off of fuel supplies to towns and cities, the consequent discontinuance of all sorts of public utilities, the stagnation of all manner of business, the freez-

ing and starving of helpless men, women and children, the spread of disease and death, the hell of crime and disorder—these would be a few of the high spots in the general cataclysm. This picture is not overdrawn, as every man knows who has kept himself informed as to conditions in Europe and tendencies in the United States. It is based on the assumption that the strike would be fought to a slow and unyielding finish, just as the shop strike is now being fought. Of course if it be assumed that the railroad managements, the Federal Government and the governments of the various states took the other horn of the dilemma and fell on their knees before the strike leaders in abject surrender, then the country would escape the dire consequences otherwise in store for it. In that event just what ransom would be exacted would rest largely within the discretion and generosity of the strikers.

The paradoxical feature of this entire situation is that a general railroad strike of the sort here slightly sketched, aside from the incidental violence and disorder, would be perfectly lawful. The violence and disorder, the slugging, kidnaping, beating up and murder might as well be authorized by law, because they are the everlasting concomitants of the thing which is authorized—the railway strike. It is euphoniously said that men strike in order to exert economic pressure on their employers and on the public. The academic theory of the strike is that the employes of an industry, in effect, lay a wager that the industry cannot be run without their labor, and they discontinue work in order to put this wager to a practical test. . . .

If a strike stopped at that point it might, indeed, be characterized as an economic contest; but no strike of any considerable proportions will ever halt at that stage. The men remaining at work who are waylaid and assaulted, their wives and children who are harassed and terrified by threats and by attacks on their homes, the laborers who are bombed in the shops, the public whose lives are endangered by wrecks, accidental or superinduced, the carriers whose buildings and rolling stock are destroyed by incendiarism—none of these would define their experiences as manifestations of economic pressure. They are naked and hideous physical force, approximating civil war. As a matter of fact the strike is a blockade, and the blockade is recognized as one of the most effective instruments of warfare. Without pausing to argue about who is responsible for the lawlessness incident to strikes, suffice it to say that one cannot conceive of a general railway strike

devoid of a large amount of lawlessness. One might as well talk about sunshine without heat or rain without moisture.

The truth is that this alleged right to strike, this system of making war on the public in order to settle controversies with the railroads, is politically, morally, and economically unsound. The continuation of such a system is not to the advantage of the public, the carriers or the employes. It will not be creditable to the legislative branch of our Government if a condition so fraught with possibilities of industrial disturbance and political revolution is permitted to survive. It will be impossible to enact effective legislation that will not arouse the antagonism of one or both of the interests involved. It is, however, perfectly feasible to strengthen existing laws in a way that will guarantee substantial justice to the carriers and employes and protect the rights of the American people.

There are certain basic principles upon which such legislation must rest.

The 110,000,000 people of this country, the producers, shippers and consumers are as a matter of right entitled to efficient and fair-priced railway transportation, and as a matter of self-preservation they must have it.

Although the railroads are privately owned and operated, Congress has time and again asserted its power over interstate commerce to protect the public against imposition and discrimination upon the part of railway managements, and the Supreme Court has upheld such legislation. By the same token Congress may intervene with statutory enactments requiring railway employes to refrain from interruptions of interstate commerce destructive of the property and lives of the people.

There rests upon the shoulders of railway managements and of railway employes a public trust—the duty of furnishing to the people efficient transportation.

Railway strikes and lockouts must be made unlawful, and impartial punishment must be prescribed for violations of the labor laws by either managements or men. The exceptional railroad managements that have stood with extended hands to receive all favorable decisions from the Railroad Labor Board, but have contrived methods of evading unfavorable decisions, must, in justice to the employes and to the public, be brought sharply to account and made as amenable to the law as the humblest section hand. . . .

It is merely a piece of fallacious rhetoric to say that an anti-strike law in the railway industry would establish involuntary servitude. No man would have to enter the railway service against his desires in times of peace, and when he did enter he would know that in a sense he was entering the public service and would therefore be subject to certain limitations and restrictions not applicable to purely private employment. He would be as free as any other citizen to change his occupation whenever he saw fit. He would understand, however, that no organization to which he might belong would be permitted to conspire to wage civil war on society and industry, and to enthrone anarchy in our republic. Civilized states have established executive and judicial machinery as a substitute for guns and bombs to protect the lives and rights of their citizens. The people have reached the conclusion that this gun feud between the carriers and their employes must stop, for two reasons: First because the fatalities are too serious among the innocent bystanders, and second because the damage done by the combatants to each other is a matter of public concern. The time has therefore arrived when the people are compelled to say that the weapons of force and oppression that have sometimes been used by the railroads against their workers must be discarded and that the weapon of the strike, which has occasionally been handled with deadly effect by the employes against the railroads and the public, must be laid aside. This method of adjudicating a civil controversy is a modern revival of the ancient absurdity of trial by combat. The result of that sort of trial was not based on justice but on brute force. The mountain feudist in our own country who resorts to a rifle may locate his adversary, but he does not by that method locate the disputed boundary line over which the trouble arose.

The Court of Force is an unjust court. The strike is not a safe method of arbitrament. A justifiable strike may be lost, and an unjustifiable strike may be won. And then, in addition to the injustice that is wrought by the judgments rendered by the Court of Force, the costs incident to the trial are enormous and they fall with ponderous, staggering weight upon both litigants alike. The strike of the shopmen will cost this country, one way and another, a half billion dollars, but it will settle no dispute, it will answer no industrial question, it will solve no social problem, it will establish no principle of immediate or ultimate benefit to compensate labor for its fearful sacrifice.

On the other hand it will impoverish the participants and will bring vast suffering to the workers in other lines of industry by retarding prosperity and increasing the cost of living. It will tend to defeat its own object by diminishing the ability of the carriers to pay wages.

If, however, Congress is to say by legislation that the carriers and their employes must surrender the high privilege they have heretofore exercised of fighting out their differences and must henceforth submit them to adjudication, then the greatest care must be used to guarantee to both parties a square deal. It must not be forgotten that there has been an insidious propaganda poured into the minds of laboring men through hundreds of publications, spreading the poisonous preachment that every branch of the Government is unjust to labor. That railroad labor has had its full share of this kind of literature can be testified by anybody who has had the opportunity to inform himself.

In legislation on the subject under discussion there should be the least possible ground for complaints of unfairness. Of course it would be a mere waste of time to endeavor to coddle the designing agitator into the approval of any law or policy of the Government, for he could be satisfied with nothing less than the overthrow of the existing order of society. It must be recognized, however, that a large part of the skilled classes of railway employes are essentially conservative men, although the drift of sentiment among them in recent years is apparently in the opposite direction.

In most of the national conventions of railway employes this year strong ground has been taken in favor of the repeal of the labor article of the Transportation Act, and it goes without saying that any move to strengthen the act by the inclusion of an anti-strike provision will be vigorously resisted. The employes demand the unhampered right to tie up the railroads whenever they consider it to their own interest. The basic reason of this is two-fold: First because they believe that their absolute power to throttle traffic will get them more than arbitration will, and second because the majority of them are advocates of government ownership, and they believe that their unrestricted power to strike will soon force a discouraged and disgruntled public to adopt government ownership. Their first conclusion is erroneous. Arbitration or adjudication of their controversies will net them more cash and comfort than the use of economic pressure will. Their second conclusion is correct. The surest way to bring about

public ownership is to demonstrate the inability of the carriers and the Government to save the public from the unbearable harassment of periodical strikes.

One just ground of complaint from the employes against the Transportation Act, as it now stands, is that the carriers have been able to evade and postpone the effectiveness of decisions of the board conferring benefits on the employes, while the employes have no possible means of escaping an objectionable decision except by striking, which is a method too drastic and costly to consider in any ordinary case. The employes are able to point to a considerable number of instances where the board's decisions have not been respected by carriers, though, of course, the great majority of the carriers have loyally lived up to the decisions of the board. In all fairness it must be conceded that the Shop Crafts in particular have borne with commendable patience somewhat exasperating conditions on certain roads. The possibility of such unfairness and inequality should be wiped out so far as it can be done by legislation. . . .

Part of the trouble given by certain of the carriers has been due to their aversion to doing business with the labor organizations on their roads. The Railroad Labor Board has consistently held that the majority of the employes in a particular class have the right to select their own representatives for purposes of conference and negotiation and to appear for them before the Labor Board.

The Transportation Act recognizes the right of the railway employes to organize, to function as organizations and to bargain collectively. It may be that if the statute were made a little more clear and emphatic on this point a few hard-boiled executives with archaic ideas of labor would cease to give trouble. Perhaps, after all, they serve a useful purpose in preventing the world from moving too fast. They offset some of the more radical labor leaders, whose normal gait is running away.

The time has passed when men can accomplish important or permanent results by antagonizing the right of labor to organize. The biggest question in the world to-day is not how to crush and destroy organized labor but how to curb and restrain its excesses. There is no place in this country for the maudlin idea of the parlor socialist that any demand of labor must necessarily be a just demand. It may be or it may not be. Labor, with its highly sensitized class consciousness, does not always reason along

straight lines. It often gives no heed whatever to the rights of those outside the ranks of its own organization. This thought serves to recall a conversation alleged to have occurred among a small group of railway executives who were discussing the doings and misdoings, mostly the latter, of certain labor organizations. One of them indignantly said, "Why, they have tried to run my road; they have demanded enormous increases in wages, vacations with pay, and soft-snap working rules." One of the other executives, after a few contemplative puffs on his cigar, replied, "Yes, my main objection to those fellows is that they are so damned much like us."

The public should accord just recognition to the fact that labor unions must be credited with a considerable part of the advancement of labor in the acquisition of just wages, decent living conditions and all that makes life worth while. A contribution so vital to such a large section of mankind is a blessing to the world as a whole. It must likewise appeal to the composite sense of justice of the people at large that, if railroad labor waives its right to strike or is by statute declared to possess no such right, to the end that railway service may be rendered more stable and efficient, then the public, through the agencies that deal with the question, must make sure that railway employes lose no advantage or benefit by this new requirement. . . .

Many people who have heretofore given the subject but superficial thought have committed the error of advocating a wage for railroad labor based upon labor in outside employment with which it is not fairly comparable. The public estimate of a just and reasonable wage for railway employes should give full weight to the training and skill required, to the degree of responsibility and to the hazards of employment. A just public will also remember that the train and engine men perform work which affords opportunity for only the slowest promotion, which does not fit a man to pass readily into some other line of business, and which separates him from his family a large part of the time.

The railway labor organizations might think that their usefulness was at an end if they were denied the privilege of fighting, but this is not true. It is the same thought the German Kaiser had—namely, that he must have a war, otherwise he was all dressed up with nowhere to go. The labor organizations render service of incalculable value to their membership entirely aside from striking and threatening to strike. This country is full of

flourishing organizations of many kinds that serve their constituents to splendid advantage in a peaceful way.

When railroad labor is given, as it is under the Transportation Act, an equal voice in the fixing of wages it should be satisfied. Public sentiment cannot be brought to approve any system that concedes to railroad labor, to all practical intents and purposes, the exclusive power to fix its own wages. Such an autocratic power over the railroads, the key industry of this country, will ultimately result in the oppression of the people and set in motion forces likely to subvert our free institutions. This, however, is the power which railroad labor now possesses under existing laws and conditions, and it is only a question of time until an effort will be made to exert it, unless there is wise and conservative legislation to prevent. Such an eventuality would bring no greater disaster to anybody than to labor itself.

Our people should not temporize with this question. It is too vital and too far-reaching to admit of partisan bickering.

The Transportation Act of 1920 was a long stride in the right direction. Results have justified its enactment but uncovered its fatal weakness. Its provisions should be clarified where necessary to the safeguarding of the rights of all concerned, and, above all, they should be made mandatory and enforceable. Then, if abuses develop in the administration of the law, let the ballot box be resorted to for redress.

This is a problem that cannot be solved by stagnant hesitation or timid retrogression. It calls for a forward movement.

CHAPTER XXVIII

THE PLUMB PLAN[1]

1. The A. B. C. of the Plumb Plan[2]

What is the Plumb Plan?

It is a plan for the public ownership and the democracy in the control of the railroads.

Who has endorsed it?

The two million organized railroad employes of America; and the American Federation of Labor, approving the principle of government ownership, has instructed its executive committee to cooperate with the officers of the railroad internationals in their effort. It also has been endorsed by several farmers' organizations.

How does it propose to buy the roads?

By issuing government bonds with which to pay for the legitimate private interests in the railroad industry.

How does it propose to operate the roads?

By a board of fifteen directors, five named by the President, to represent the public; five elected by the operating officers; five elected by the classified employes.

Does this mean government operation?

No; it is operation by a board in which those having the responsibility have also the authority. It is superior to government operation because it prevents control by an inefficient bureaucracy; and is true democracy since it gives the men engaged in the industry a voice in its management.

What becomes of the surplus?

After operating expenses are paid, and fixed charges are met, including the interest on outstanding government securities,

[1] See Jones, pp. 491–497.

[2] From a pamphlet published by the Plumb Plan League. The Plumb Plan was the subject of widespread discussion during 1919; and still has numerous adherents.—Ed.

the surplus is divided equally between the Government and the men. The employe's portion is to be divided between the managerial and classified employes, the former receiving double the rate received by the latter class. This is not a profit, since the corporation has no capital. What the men receive is a dividend on efficiency.

Is this a bonus system?

No, it is giving those who increase production a share of the results their increased effort has produced; and this share is theirs for as long as they are actually in the service, and is not forfeitable.

Why do operating officials receive the larger rate of dividend?

Because it serves as a greater stimulus to the group with the most responsibility. And since the operating officials would lose dividends if wages were increased it acts automatically to prevent collusion between labor directors and the operating directors to outvote the public's directors in raising wages beyond a reasonable level. The chief argument against the plan is that the public loses control of its own property, and that the men in charge cannot be prevented from combining to pay themselves extortionate wages. This method of sharing dividends sets up a natural barrier against collusion.

Is this the only protection for the public?

No, the rate-making power remains with the Interstate Commerce Commission, and if wages were raised so high that rates had to be increased, the Commission could refuse to change them, and shippers might appeal to the courts for redress. If the operation by the directors results in a deficit Congress can revoke their charter.

Does this difference in dividends create hostility between officials and men?

No, because without harmony between them neither group can earn dividends. An official in working for his own dividend is working for the dividend of his subordinates, for one cannot gain unless all gain.

Does the plan assure a decrease in rates?

It provides that when the Government's share of the surplus is 5 per cent or more of the gross operating revenue, rates

shall be reduced accordingly to absorb the amount the government receives. For instance: If the entire surplus one year is $500,000,000, and this is 10 per cent of the gross operating revenue, the Government receives $250,000,000. And because this is 5 per cent, rates are decreased 5 per cent. See what follows. Without new economies or new business the profits the next year would be only $250,000,000, and the employes and the Government would receive only half the amount of the year before. But decreased rates mean more business; and also, the reduction in dividends would stimulate the employes to improve their operation by applying better methods. So the tendency is to assure constantly decreasing rates, to add to the volume of business, and to give the most efficient service human ingenuity and devotion can provide. Decreased rates mean cheaper commodities; and so, through the effectiveness of the railroads, the purchasing power of money is increased, not only for the railroad man, but for every wage earner and every purchaser.

What does the Government do with its share of the surplus?

It invests it in improvements and extensions, thus adding to the value of the railroads without adding to the fixed charges. It retires the outstanding bonds, thus reducing the fixed charges. Ultimately the public has its railroad service at cost.

Does the Government pay for all extensions?

No, the community benefited must pay if it can; if it is able to pay all, the building of the extension is obligatory. If it only pays part, the Government pays the remainder, but only makes the extension as it deems wise. And where the general public and not a local community would be benefited, the Government pays the whole bill.

How are disputes between officials and men adjusted?

By boards, to which the operating officials elect five members and the men, five members. In case of failure to reach an adjustment, the case is appealed to the directors.

Who determines the rate of wages?

The board of directors.

Who supervises the purchase of the roads?

A Purchasing Board, composed of the Interstate Commerce Commission and three directors of the new government corporation, one director from each group.

Who decides the value of the private interest in the railroads?

The courts. It is a judicial question, and is to be answered only after an examination of the charters of the existing companies, the laws under which they are created, and the manner in which the company has lived up to its charter and these laws.

Will the public have to pay for watered stock?

No. The public will probably pay less than two-thirds of what the railroads claim as their value.

Are there other savings?

Yes, the public can obtain the money to purchase the lines at 4 per cent, whereas the public is now charged rates to guarantee the roads 6½ per cent on their money. The saving on the present capital account of the railroads would be about $400,000,000, and on an honest valuation would be nearly twice this sum. The Plumb Plan provides for a sinking fund and every year one of the fixed charges would be 1 per cent of the outstanding indebtedness, to be used in retiring the bonds. The Government also uses its profit in retiring bonds, so eventually, probably in fifty years, the people would own the roads debt-free. A further saving would be in the operation of the roads as a unified system, which permits the interchange of equipment, the end of wasteful competition, and greater economy in buying supplies. Under this plan passenger rates of 1½ cents a mile, and a reduction of freight rates by 40 per cent appear reasonable.

Why is it called the Plumb Plan?

Because it was conceived by Glenn E. Plumb, General Counsel for the Organized Railway Employes of America. . . .

2. A Defence of the Plan [1]

The two million organized railroad employees of America have endorsed a plan for the government purchase and the democratic

[1] From Glenn E. Plumb, "Labor's Solution of the Railroad Problem," *Nation*, vol. 109, pp. 200–201 (August 16, 1919). Reproduced by permission of the publisher.

operation of the railroads. The American Federation of Labor has approved the plan in principle and directed its executive committee to coöperate with the railway organizations in their endeavor. Mr. Gompers has assumed the honorary presidency of the league through which the employees are to carry their campaign to the country. So it is not saying too much to name the plan labor's solution of the railroad problem; and it is unnecessary to point to the significance of the fact that the five and a half million skilled workers of America are united in such a demand.

In brief the plan provides:

1. For the purchase by the Government of the private interest in the railroads.

2. For the operation of the roads as a unified system by a board composed of fifteen directors, five to be appointed by the President to represent the public, five to be elected by the operating officials, and five by the other employees.

3. The corporation has no money capital. At the close of the year, after paying all expenses of operating and fixed charges, the surplus is divided into two equal sums, one to be paid to the Government, the other to the operating officials and other employees as a dividend on labor. When the Government's share, in any given year, is more than five per cent. of the gross operating revenue, the Interstate Commerce Commission will be obliged to reduce rates to absorb the amount the Government has received. The employees' share is paid to all employees; but the operating officials receive twice the rate of dividend paid to the other workers.

4. Extensions so far as possible are to be paid for by the community benefited; and when a community pays the entire sum, the building of the extension is obligatory upon the corporation. If the community cannot pay the full cost, the Government pays the remainder out of its profit, and as it deems wise. The Government can, at its own expense, build extensions through regions that would receive no local benefit, if such an extension would be in the interest of the general public.

5. A sinking fund is set aside from the gross operating revenue for the retirement of the government securities with which the property is purchased. Pending the determination of value by the courts, the railroad companies receive half the present rental, this to be deducted from the eventual purchase price. Ultimately all the debt from purchase is cancelled.

6. The Interstate Commerce Commission retains all of its present rate-fixing powers.

7. On the failure of the corporation to live up to the terms of its contract, Congress may revoke its charter.

No matter how the railroads are operated, there are three partners in the industry, capital and labor and the public. The success of operation depends, in the nature of things, on the harmony of this partnership. If, as in the past, capital operates the lines with the chief aim of making profit for itself, there is no incentive to labor to increase its contribution, since every additional effort goes to enrich the employers only. It is a self-evident truth that until management is wholly efficient, the rate the public pays is excessive, and efficiency, being altogether a problem of human factors, is unattainable while there is no inducement to coöperation between operating officials and their men, or to the introduction of improved methods depending on a high spirit of coöperation. It is also self-evident that until the public keeps a check on railroad expenditures and finance, there is no prevention of the practice of falsifying the capital account as a basis for an increase of rates.

The public holds over the railroads the rate-making power, but it is impotent to deal with the two principal causes of high rates. A low degree of managerial skill cannot be taken into account at a rate hearing; and the present fictitious value of railroads, as commonly accepted, shows that the rate-makers have fallen into the snares of fallacious reasoning in according rights to which, we believe, the roads were never entitled. It is labor's proposal to readjust the interest in the railroads to a new balance. Instead of giving capital its head, and the public only an ineffectual rein, and leaving labor helpless and disheartened between the two, it asks for a recognition of two incontrovertible truths: that skill is the prime force in the railroad industry; and that beyond giving to the capital honestly invested in the public service a reasonable return, the public owes it nothing.

The division of dividends among employees is designed as an incentive to skill. As the railroads are now managed, there is no inducement, beyond the hope the lowliest man may hold of rising from the ranks. This chance, often enough pointed to by the individual Americans who justify it, comes, however, to only a relatively small number of men. Even if every financier or industrial leader in America had climbed from the shops to their places

of authority, the proportion of those who could not so advance is overwhelmingly large. Nor is there any reason why those who are left behind should be allured by the very slight prospect of "going up" in the world. If the only spur to a man's better effort in his work is the hope to graduate from it, he is not animated by a very praiseworthy desire. Society should give men contentment with the work at hand, and their ambition should be directed to its better performance. True, those who rose from the ranks unquestionably were able to because of their fidelity in the lesser fields; but it is a poor guerdon for those they left behind that a less spectacular skill must be, like virtue, its own reward. Every man is a potentiality of energy which society by one means or another is contriving to develop for the social good. It is the very purpose of civilization to increase the contribution of the individual; to offer, in place of dire necessity, a more generous inducement for the doing of the world's work.

The railroads now set no price on their employees' initiative. If collectively or singly they should undertake a stroke of economy, they have no reward. That is, if they increase production, they merely add to the profits of capital. There are countless methods in the broad category of "scientific management" by which the railroad service could be enormously cheapened and improved; but they are not introduced. Why? Workers detest the inspector's stop-watch and the efficiency engineer's charts, but can they be reasonably asked to produce more for some one else's enrichment? The managerial experts are trying to function in violation of human law. But let these managerial reforms be advanced in accordance with that law, and let them lead to greater freedom rather than further enslavement, and they are bound to succeed. The entire doctrine of managerial engineering has been mistaken in attempting to bring about increased production without observing the simple tenets of democracy. If production, not profits, is the first objective of industry, it can only be assured by rational recognition of the fundamental characteristic of the human being.

The argument is made that labor is merely asking the Government to buy the railroads and turn them over to the employees for their free pleasure. It is pointed out that the operating employees and the classified employees between them have ten representatives on the board of directors to the public's five. It is asked why the public, having the ownership of the property, should resign the control. And what is to prevent collusion be-

tween the two groups of employees for the increase of wages and the ruin of the service? The answer is simple. In the first place, there are no profits, as such; there are to be dividends on increased efficiency. The plan provides for the continual reduction of rates as these dividends rise above a given level.

Then, too, there should be no confusion about the percentage of the dividends. The difference between ten per cent. of gross operating revenue and ten per cent. on capital is a matter of hundreds of millions of dollars. Ten per cent. of a gross operating revenue of four billion dollars would be $400,000,000, while ten per cent. of the present capital account of the roads would be $1,900,000,000. The rate of dividend falling to the employees for increased production is not comparable with the present rate of dividend to capital. Under the labor plan, if in any given year the Government's share of profits is more than five per cent. of the gross operating revenue, rates must be reduced five per cent. Supposing the Government shares a 12 per cent. surplus on, say, a $4,000,000,000 operating revenue; it then receives $240,000,000, or 6 per cent. Then the rates must be reduced 6 per cent. If there are no further savings and the volume of traffic is not increased in the ensuing year, the men have only $240,000,000 to share with the State. It is our belief that such a reduction must tend to stimulate the men to a further improvement of service; and that it will, in the nature of things, increase the volume of business. So from two sources of increased production—the actually created business and the new skill—labor restores its dividends. By this method, every dollar a railroad man receives represents a reward for a service from which the entire nation has derived a benefit. It is folly to confuse such an outcome with the profiteering of present-day industrial life.

There can be, under the plan, no profit-making, as the word usually is construed, since there is no capital on which a return has to be made. The retirement of bonds and the interest on them are a fixed charge. That, if you please, is the only profit-making in the proposal—the sinking fund and the annual interest, probably four per cent., on the government securities. The dividends to labor are in an altogether different category; they are a share in increased production; they are, precisely speaking, one-half of the surplus from new business, and this for only a limited time. And since every dollar of new business for the railroads is won by improved and cheaper service, it is a gain for every industry. . .

Still, it can be argued that the entire purpose of the plan might be defeated by the indolent policy of the employees, who, instead of exerting more effort to create new business, could decide merely to raise wages, and so impose a selfish tax upon the public. If this were possible, it would suffice to discredit the entire plan. But the plan safeguards the public's rights; it does not take from the State the control of its property, but only calls for a majority control of the operation of the property, and this under careful provisions. The State retains the absolute rate-making power. Supposing the workers do unite with their operating officials for an unreasonable increase in wages; they still do not have the power to raise the rates to provide the increased revenue. They must convince the public's Interstate Commerce Commission of the justice of their action. And if they increase wages without the necessary revenue, and a deficit arise, Congress can forfeit the lease.

One further possibility is cited against the plan. What if the men's dividends in some years have been, let us say, five per cent. of gross operating revenue, or about $200,000,000; is there anything to prevent the employees from deciding to "play safe" for the next year, and increase wages $200,000,000? Would it not be reasonable for the men to say: "We have earned this dividend, but we are likely to lose it through a new reduction of rates; so we will simply make sure of it by increasing wages by this amount"? To prevent this, the plan gives to the operating employees twice the rate of dividend given to the classified employees. When wages are increased, the operating employee receives only the same rate of increase as the classified employee. This dividend, however, is worth to him twice as much as the salary advance; and even if the dividend were cut down by a reduction in transportation charges, it would probably remain more than the salary increase. In this manner it becomes the primary interest of the operating employees to receive their share of new business always in dividends, and not in added wages; and even if the classified employees should prefer the wage increase, they would be outvoted two to one on the board of directors.

The saving to the public would commence immediately, for the difference in the interest paid for capital borrowed by the Government and capital provided by private investors is from two to two and one-half per cent. on the capital account. This, on a capital account of $12,000,000,000, would be from $240,000,000 to $300,000,000. Today the public is asked to pay on a

watered capital account of $19,000,000,000. So the real saving assuming the conservative estimate of twelve billions to be correct, would be from $380,000,000 to $475,000,000. No one, of course, can measure the savings possible if the roads are operated as a unified system; the interchange of equipment, the centralized purchases, and the discontinuance of wasteful competition would save a large sum. Nor can any one estimate the possibilities of scientific management under democratic control. But it seems safe to predict a passenger rate of 1½ cents a mile, and a 35 to 40 per cent. reduction in freight rates. The Government spends its share of the surplus in extensions and improvements, and in retiring outstanding bonds. The physical value of the service is being continually raised without a corresponding raise in rates; and the capital cost is being continually diminished, until it finally disappears. Thus, ultimately, transportation will be furnished at cost.

3. A Criticism of the Plan [1]

The "Plumb Plan League" has been organized to promote adoption of the plan of railroad ownership and management devised by Glenn E. Plumb. Warren S. Stone, Grand Chief of the Brotherhood of Locomotive Engineers, is president of the League, and the heads of fourteen other railway labor organizations are vice presidents. A pamphlet entitled "The A B C of the Plumb Plan" is being widely distributed by the league. It gives in question and answer form the details of the plan and the arguments in favor of it.

Any plan for the future ownership and management of the railways which the organized railway employees support is entitled to respectful consideration and to discussion upon its merits. The railway employees are a numerous body of American citizens, and because they are employees of the railways they will be as much affected, perhaps more affected, by the future of the railroads than any other class.

The "A B C," which apparently was prepared by Mr. Plumb, affords a basis for the discussion of his plan. It claims that enormous economies will be effected if the plan is adopted; that in consequence it will be possible to pay railway employees higher wages, to make large reductions in freight and passenger rates,

[1] From "The 'A B C' of the Plumb Plan," *Railway Age*, vol. 67, pp. 139–141 (July 25, 1919). Reproduced by permission.

and at the same time earn a surplus, which it is proposed should be divided between the officers and employees and the government. It is time to measure these claims and arguments by the standard of actual conditions and facts in order to determine what validity they have.

Under the Plumb Plan the public would buy the railways, issuing bonds in payment for them. It would delegate their operation to a board of fifteen members, five appointed by the President of the United States, five by railway officers, and five by the classified railway employees. The board of directors would fix wages and salaries, as well as manage the roads, while the Interstate Commerce Commission would continue to fix passenger and freight rates. Disputes between officers and employees would be adjusted by boards to which the officers would elect five members and the men five. In case of failure to reach adjustment of a dispute it would be appealed to the directors. One-half of any surplus over interest charges earned would, as already stated, go to the government, and be invested in improvements and extensions and used to retire the bonds issued to buy the roads. The communities benefited would be required to pay for extensions if they could. Where, however, the general public and not a local community would be benefited the government would pay for the extensions. Doubtless, also, the government would have to pay for all improvements which could not be made from surplus earnings.

It is claimed that this is "a plan for the public ownership and the democracy in the control of the railroads." It is hard to see how it can be seriously claimed that it provides for "democracy in the control of the railroads," since it contemplates the purchase of the roads by all the people and their management by a board two-thirds of whose members would represent only that approximately one-fiftieth of the people who are employed by the railroads.

One ground upon which it is claimed that a large saving would be made under this plan is that "the public can obtain the money to purchase the lines at 4 per cent., whereas the public is now charged rates to guarantee the roads 6 1-2 per. cent. on their money. The saving on the present capital account of the railroads

would be about $400,000,000 and on an honest valuation would be nearly twice this sum."

These sentences contain several statements which are erroneous. The public has never been "charged rates to guarantee the roads 6 1-2 per cent. on their money." The last year for which there are complete statistics of the Interstate Commerce Commission showing the property investment, the net capitalization and the net operating income of the railways, is the year ended December 31, 1916. In that year the percentage earned by the railways on their property investment was 5.8 per cent., and this is the largest percentage they ever earned. In the preceding five years the average earned, as reported by the Interstate Commerce Commission, was 4.56 per cent. However, it is undoubtedly true that the companies should be allowed to earn an average of at least 6 per cent. on their property investment in order to enable them to operate successfully and raise sufficient new capital for extensions and improvements.

It is also incorrect, however, to say that the public can obtain money to purchase the lines at 4 per cent. The government finally had to pay as much as 4 3-4 per cent. to raise about as much money to carry on the war as the reported property investment of the railroads, which is approximately $18,000,000,000. Since it was finally forced to pay 4 3-4 per cent to raise money to carry on the war, it cannot be assumed that it could raise enough to buy the railroads for less than 5 per cent. Now, if it allowed the railroads to earn 6 per cent. upon $18,000,000,000 this would be $1,080,000,000 a year, while if it bought them for $18,000,000,000 and paid five per cent. upon it, the interest would be $900,000,000 a year, or only $180,000,000 less than the net operating income of the properties would be at 6 per cent. Furthermore, if past experience is any criterion, if the railways earned 6 per cent. they would put part of it back into improvements and extensions, while if the government earned only 5 per cent. on the purchase price mentioned it would have to pay it all out in interest.

But, the "A B C" adds, a much larger saving even than $400,000,000 a year would be made if the roads were bought "on an honest valuation"; and elsewhere it asserts "the public will probably pay less than two-thirds of what the railroads claim as their value." The only foundation for this assertion is that some railroads are known to be over-capitalized. But other railroads are known to be under-capitalized. For example, the Pennsylvania

System is capitalized at $430,000,000 less than the actual investment in it. Other large systems also are under-capitalized. The under-capitalized roads will more than offset the over-capitalized roads. Furthermore, the cost of reproduction must be given great weight in valuation; and the cost of reproducing the roads on the basis of present wages and prices would be vastly greater than their book cost. The "A B C" says that the courts would decide the value of the railroads if the public bought them; and the courts unquestionably would hold that the value which must be placed on them is not their original cost, but their present value. Instead of paying less than their present capitalization the public undoubtedly would have to pay much more for them than their present total capitalization or total reported property investment. Any person who really believes that under government ownership large savings in the capital charge of the railroads would be made is either ignorant of the facts or is deliberately misleading himself.

Besides reducing the capital charge, the "A B C" claims that the adoption of the Plumb Plan would result in a large reduction of operating expenses. For example, "A further saving" it is asserted, "would be in the operation of the roads as a unified system, which permits the interchange of equipment, the end of wasteful competition, and greater economy in buying supplies." But the roads have been operated as a unified system under government control for a year and half and are still being so operated. The present director general of railroads, Walker D. Hines, recently stated in testifying before the House Committee on Appropriations: "I think we have already gotten the benefit both last year and the early part of this year of the economies from unification." Mr. Hines doubtless knows as much about this matter as the author of the "A B C"; and the only way he intimated greater economy could be secured under unified operation is by getting a better class of labor, especially skilled labor.

Another argument made for the Plumb Plan is that it would give officers and employees an increased incentive to efficiency. As already indicated, officers and employees are to receive one-half of any surplus over interest charges that may be earned. Their share of the surplus is to be divided pro rata according to their salaries and wages among the officers and employees except that the officers are to receive twice as great amounts of "dividends" in proportion

to their salaries as the employees receive in proportion to their wages. But salaries and wages are to be fixed by the board of directors, two-thirds of whose members will be elected by the officers and employees. How can it be assumed that under this arrangement salaries and wages would not be raised so high as to prevent any surplus from being earned? If a surplus were earned it would have to be divided with the government, while if salaries and wages were raised enough to prevent a surplus from being earned the officers and employees would get all of what would otherwise be earned as a surplus.

The answer made by the "A B C" is that the officers would be prevented from entering into collusion with the employees to advance salaries and wages because under this plan the officers would get twice as large a proportion of the surplus as the employees, while, on the other hand, if salaries and wages were raised so much as to prevent a surplus from being earned, the officers would be prevented from getting their "large dividends." But if a raise in salaries and wages were made the officers would know just how much they would benefit by it, while they would never know in any year how much they are going to get from the surplus at the end of the year, or, indeed whether there would ever be any surplus. Therefore the officers as well as the employees would have a far stronger incentive to raise salaries and wages than to try to earn a surplus. Certainly, this would be true at the start; for, if the roads were turned over to the officers and employees for operation under this plan without an advance of rates they would start with a deficit of one-half to three-fourths of a billion dollars a year. This would afford little ground for hope of a surplus.

Not only would this plan not afford any special incentive to officers and men to operate the properties efficiently in order to earn a surplus, but the plan itself would make efficient operation impossible. Two-thirds of the members of the managing board would be selected by the officers and the employees. But the officers are scattered all over the United States and are of many ranks and classes. The same thing is true of the employees. No means is conceivable by which men of so many ranks and classes, scattered all over the country, could possibly know and select as their representatives on the board of directors the men most competent to manage the railroads. A board thus selected would be

certain not to be composed of men of the great knowledge, experience and ability needed. The board, in turn, would have to select the officers of the individual lines. But a board composed of men themselves wanting in needed knowledge, experience and ability, would be incapable of selecting or indisposed to select men of sufficient knowledge, experience and ability to manage the various railway lines.

It may be said that the present officers of the railways would be retained. But it is doubtful if a board composed one-third of government appointees and one-third of labor appointees would be disposed to keep the present officers. Furthermore, it is certain that most of the present higher officers would not consent to work under the direction of such a board. They would quit the railroad business and go into other lines. Even if the present officers did stay they are not immortal. Successors to them would have to be chosen from time to time; and competent successors could not and would not be developed and chosen under the organization proposed in the Plumb Plan. This ought to be plain to every intelligent railway employee. But if the railroads did not have competent officers they could not and would not be efficiently managed. If they were not efficiently managed, expenses would constantly increase, and service constantly deteriorate.

As a logical conclusion to the argument that vast economies would be effected under the Plumb Plan, the "A B C" makes the following statement: "Under this plan passenger rates of 1 1-2 cents a mile and the reduction of freight rates by 40 per cent. would be reasonable."

Just how much dependence railway employees and other persons can safely put upon the arguments and statements of fact made in the "A B C" will be indicated by the following analysis of this particular statement, which evidently was made to forestall opposition to the plan by travelers and shippers. During the first five months of 1919 the passenger earnings of the railroads were 50 per cent. greater and the freight earnings 20 per cent. greater than in the corresponding months of 1917. Total earnings were 25 per cent. greater and total operating expenses 57 per cent. greater than in the same months of 1917. If these items of earnings and expenses shall throughout the year 1919 bear the same ratio to the similar items for 1917 as they did during the first five months of

this year, passenger earnings for the entire year 1919 will be $1,238,000,000; freight earnings will be $3,395,000,000; total earnings will be $5,051,000,000; and total operating expenses will be $4,479,000,000. Now, passenger rates at present are 3 cents a mile. Therefore a reduction of them to 1 1-2 cents would reduce passenger earnings per year approximately $614,000,000. A 40 per cent. reduction of freight rates would reduce freight earnings per year approximately $1,358,000,000. These reductions in passenger and freight rates, on the basis of present business, would reduce total earnings per year from about $5,051,000,000 to about $3,075,000,000. But as we have seen, total operating expenses are now running at the rate of $4,479,000,000 a year. Therefore, after the reductions in earnings caused by these reductions in rates had been made, the total operating expenses of the roads would exceed their total earnings by $1,405,000,000 a year. But railway taxes as well as operating expenses must be paid. Taxes and operating expenses together would exceed total earnings by about $1,600,000,000 a year. Then if in addition there was, say, $900,000,000 a year interest to meet, the deficit to be paid by the public from taxes would be $2,500,000,000 a year. Talk about the "surplus" to be divided between officers and employees and the public! And while the "plan" proposes that the public should get only one-half of the surplus, if there should be one, it also proposes that the public should get all of the deficit, if there should be one. It would be a singular kind of "democracy in the control of the railroads" which would make the public pay the entire bill for buying the roads, give it only one-third of the managing directors, give it only one-half of the surplus if there was any, and send it the entire bill for the deficit if there was one!

But, it is said, the reduced rates would cause an increase of traffic. No doubt. But any increase in the traffic to be handled would also cause an increase of expenses. We are curious to know how much of an increase of traffic the author of the Plumb Plan thinks would be sufficient to offset the increase of expenses which would be caused by an increase of business and in addition a deficit of about $2,500,000,000 a year.

It can hardly be necessary to carry the analysis of the Plumb Plan and its "A B C" any further to show how preposterous they are. In fact, we have taken the trouble seriously to analyze them

at all only because earnest and honest people have been misled in the past by equally preposterous arguments and assertions. We have repeatedly recalled that, in December, 1917, within two weeks of the time that government operation was adopted, an advocate of government ownership, in testifying before a Senate Committee in Washington, estimated that under unified government operation a reduction of $ 400,000,000 a year in railway operating expenses could be made. The country has now had one and a half years of government operation; and at present operating expenses are running $1,600,000,000 a year more than they were when this advocate of government operation made his estimate, and $2,000,000,000 a year more than he estimated they would run. Yet there were many people who accepted such arguments of advocates of government operation before it had been tried. It is to be feared that unless they are answered again and again, such assertions and arguments as those advanced in support of the Plumb Plan also will be seriously accepted.

Railway employees are contributing money to pay for the circulation of the "A B C" and other literature advocating the ownership of the railroads by the public and their management by the employees. It will be wise for the employees to study for themselves the statements made in this literature and test it by the facts, before they help in its distribution. Doubtless many employees are supporting the Plumb Plan because they believe its adoption would inure to their special benefit as a class. They could not be more mistaken. A plan better adapted to cause inefficiency and waste in the operation of the railroads could hardly be devised; and no class have more to lose in the long run by inefficient management of the railroads than the employees.

Besides, railway employees have nothing to gain and much to lose by supporting a plan of railroad ownership and management which is adapted, as this one is, to give the public the impression that it is intended to promote the selfish interests of the employees regardless of its effects upon the public. No plan which gives this impression will be adopted; but its support by the employees is sure in time to create public opinion hostile to them and their organizations.

PART VII

CONFLICT OF STATE AND NATION

CHAPTER XXIX

THE BEGINNING OF STATE REGULATION

THE GRANGER MOVEMENT [1]

The great Know-Nothing movement, so called, which swept over the United States about twenty years ago, apparently originated without cause, raged subject to no law, and finally subsided, having produced no permanent results. It was a species of popular squall preceding the long, violent tempest of the Rebellion. In this respect it furnished a striking exception to the general principles which mark the rise and development of widespread popular agitations. They seldom originate without cause; and, in spite of blunders and mismanagement, rarely pass away without having contributed something worth having to that general result which makes up the conditions under which we live. This is especially true of that Granger movement, which, during the last four years, has played a most prominent part in the politics of certain of the Northwestern States, and resembled the Know-Nothing movement only in its more prominent and least creditable features. It is quite apparent, however, that the time has now come when the Granger can be looked upon as a phenomenon of the past, and treated in a spirit of critical justice. Hitherto this has not been done. In the West the Granger has been "inside politics," and the politicians and editors of rival factions have vied with each other in flattering his vanity, extenuating his shortcomings, and excusing his misdeeds. In the East, on the other hand, the public mind has been mainly impressed by certain striking episodes in his movement, which, naturally, were almost always those reflecting the least credit upon it: of this character was the defeat at the polls of Chief Justice Lawrence of Illinois, for having presumed to decide a constitutional issue which arose before him as a judge, on principles of law rather than in obedience to a popular demand: or, again, the "Potter Law," so called, of Wisconsin, which seemed designed to operate as a practical con-

[1] From C. F. Adams, Jr., "The Granger Movement," *North American Review*, vol. 120, pp. 394–424 (April, 1875). Reproduced by permission. See Jones, pp. 185–209, and Vanderblue and Burgess, pp. 3–8, 15–16.

fiscation of many millions of foreign capital invested in the public improvements of that State; or, finally, the Illinois Railroad Law, which was ingeniously framed so as to make those who were to use the railroads of Illinois the final arbiters as to what it was reasonable they should pay for such use. Such episodes as these have led the people of the East to regard the Granger movement as one of those causeless, unjustifiable, and outrageous manifestations, nearly allied to agrarianism, which attempt to perpetrate under the forms of law the most wanton assaults upon property. It is not necessary to have a very exalted opinion either of the Granger movement or of the Granger type of politicians and thinkers to assert that the conclusion last stated does it and them scant justice. The simple truth is that the Granger excitement was not causeless, and that, in spite of the blunders which marked its career, it has done a great deal of very good work.

To appreciate this or any other popular movement, it is necessary to have a somewhat definite conception of its surroundings, —of the various conditions, social, political, economical, and geographical, among which it manifests itself. So far as they are necessary to an intelligent judgment, these may, in the present case, be very briefly stated, and they are not without their interest. In the first place we have a young agricultural community, which has grown up with unprecedented rapidity in the very centre of the continent, many hundreds of miles away from those great centres of human industry to which it must look for its markets and sources of supply. Such a fundamental condition as that just referred to necessarily implies a great deal. New social organizations cannot enjoy that accumulation of knowledge, of education, and of political habits which is found among people of the same race but of an older civilization; to look for it is as unreasonable as to look for an equal degree of wealth. The people of the West are accordingly always more or less restless under the restraints of law; nor do they appreciate so fully as the people of New England the immense value of an established credit and an unquestioned good name. To many among them the immediate good is apt to appear as the greatest ultimate good; and in rough, energetic fashion they view with undisguised contempt those of their fellow-creatures who believe in such tedious old saws as that "the more haste, the less speed." The straightest way home is almost always, in their opinion, the shortest way home; and, indeed, if, in following it, they almost surely come to a bog or

swamp, they generally contrive somehow to wallow through, thanks to an exuberant native vigor, though by no means always in an undishevelled condition. They thus see an evil, a wrong, with great clearness; it impresses itself most powerfully on their fancies; seeing it thus, feeling it thus, they go directly at its most obvious manifestation, and do not often stop to look for a hidden cause.

Accordingly, within the last ten years, the public mind of the West has dwelt upon railroads in two wholly different moods. During the first five years,—those between 1865 and 1870,—the fact of geographical isolation was seen clearly and felt strongly. The insufficiency of Western capital and the pressing need of new channels of communication with the East assumed an ever-increasing prominence, and thus railroads, more railroads, were the constant longing of the Western man and the unceasing burden of his speech. He found his way—loaded with maps and plans and prospectuses, and stock and bonds and land grants—into every money market of the world. Railroads could not, he thought, be purchased at too high a price; no inducements were too large with which to tempt foreign capital. The Western imagination was thoroughly fired; and so, at last, was Eastern cupidity:—and the result was the disastrous railroad mania which culminated in the panic of 1873. Through a period of five years capital flowed to the West in an apparently inexhaustible stream, and under its influence railroads were constructed as if by magic. The best and the most preposterous lines were equally built; competing line was run upon competing line between the great centres; while other lines were laid out from points where no one lived to points where no one wanted to go. In the Western States and Territories alone, during the five years which preceded the outbreak of the Granger movement, not less than five hundred million dollars of actual wealth were invested in the construction of railroads. Accordingly the number of miles of road in operation in Illinois is stated to have risen from 3,191 in 1866 to 5,904 in 1871; those in Wisconsin, from 1,036 to 1,725; those in Iowa, from 1,283 to 3,160; those in Minnesota, from 482 to 1,612; those in Nebraska, from 473 to 943; while Kansas during the same period ran up from 494 miles to 1,760. These are the six essentially Granger States, and in them alone the increase of railroad mileage in the six years between 1867 and 1873 was from 6,992 to 17,645, or no less than 254 per cent.

Thus about the year 1870 the Western mind began to appreciate the fact that its railroad system was secured. Not unnaturally it now began also to count its cost, and to realize that, though the West had the use of this magnificent railroad development, and could not be deprived of it, yet she did not own it, and was, moreover, bound to pay for its use according to the bonds given anterior to its construction. In other words, exactly what might have been anticipated now began to appear. In her over-eagerness the West had made an improvident bargain; she had given for her longed-for-railroads all that she had, all that any one asked; and now she had them, and began to shrewdly suspect that her bargain had after all been somewhat of the hardest. It was, indeed, a case of absentee ownership, with all that those words imply; and when that is said one great cause of the near-impending trouble is disclosed.

Macaulay somewhere describes the condition of affairs brought about in India in the last century, through the fact that the stock of the East India Company was held exclusively in England, while the empire from which the company drew its income was in Hindostan. As a consequence the servants of the company thought only of the distant board of direction, at whose will they held their places, and their one care was to satisfy its incessant demand for dividends, regardless of the misery their exactions caused. The illustration is a somewhat strong one, but it offers a vivid idea of the abuses almost always incident to absentee ownership. In a very modified form the same abuses existed in connection with the Western railroad system. Those who owned it did not live in the West, nor did they know much of the West; they simply knew that they held bonds or stock of certain Western roads, upon the income derived from which they depended for support; accordingly, if that income were not forthcoming, it needed no prophet to foresee that there would be discontent and trouble in the next stockholders' meeting. The roads, also, were managed in the West by shrewd men, who fully took in the exact posture of affairs; they knew perfectly well at whose will they held their positions, and they knew just what was expected from them. Men were wanted for the local management of the roads who would keep up the condition of the property and at the same time earn dividends. Men of this sort might feel secure in their positions. As for discontent along the lines of the railroads, or a growing want of sympathy between the companies and the com-

munities they served,—with such matters those having charge of the operation of the railroads troubled themselves but little. They did not undertake to serve or to satisfy two sets of masters, and those whom they did undertake to serve were the holders of the stock and bonds, and did not live on the prairies. Meanwhile those who did live upon the prairies were not East-Indians, and there was little probability that they would long submit to any very appreciable ignoring of their rights. They had also very respectable grievances to complain of; not oppressions, of course, but something far more likely to stir that high-spirited, restless community into measures of retaliation than were all the oppressions of the East India Company to rouse the Asiatics. These grievances originated in two causes, and to one or the other of these two causes could generally be traced nearly all that hostility which gave the Granger movement such power and public sympathy as it had; these were, in the first place, Competition, and, in the next place, Bad Manners.

As respects competition, it is not at first very obvious to a person who has not made a special study of the subject why this great desideratum to all branches of trade under ordinary circumstances should in the case of railroads lead directly to an outbreak of popular discontent. Yet nothing is better established than that it does lead to this, and that not in the West alone, but here in the East and in Europe. So well is this established that in certain countries of Europe, and notably in France, competition among railroads is especially discouraged with a view to avoiding this very result. The people of the West, however, were very far from foreseeing any such contingency, and they undertook the construction of their railroad system with an implicit reliance on the efficacy of competition to regulate all its operations. They fancied that railroads in the work of transportation would find themselves subject to a law of supply and demand exactly in the same degree as factories and mills in the production of cotton cloth or of flour. Indeed, this idea is even yet not wholly eradicated from the minds of many very intelligent men who have thought but little on the subject. The simple truth is that competition, properly so called, among railroads, except as a perturbing element, is simply impossible. It is impossible for two reasons: in the first place, to have it at all, every locality must be served by at least two independent and competing railroad routes, and it is a physical impossibility that nine points out of ten should have more than one; in

the second place, it is obvious that an active competition between two or more agencies,—the number, however, being always very limited,—no one of which can withdraw from the field, must necessarily result in the complete mastery of the stronger and the ultimate absorption of the weaker. In other words, where combination or absorption is possible, continued and sustained competition is not possible; and the truth of this aphorism has been demonstrated through forty years of railroad history. The distinction between a competition where the field is open to the whole world and one where it is confined to a few monopolizing agencies is very obvious,—competition of the first description is an end, an ultimate condition; that of the second is a means to an end, a mere phase of evolution. People still fail to realize the full significance of this proposition, because the consequences which must result from it do not take place at once. The range of railroad competition is continually spreading, and it requires time for the necessary combinations to work themselves out; nevertheless, the results in this direction which the last ten years have brought about are very significant of the inevitable in the future.

The people of the West eagerly invited foreigners to build railroads for them; and it was not until after their system was practically constructed that they were made, through bitter experience, to realize that competition between its members was producing results neither such as had been anticipated nor such as were altogether satisfactory. They found, in a word, that while the result of ordinary competition was to reduce and to equalize prices, the result of railroad competition was to produce local inequalities and to arbitrarily raise and depress prices. The railroads of the West had been built a great deal too rapidly, and the business of the country could not support them; those immediately in charge of them were under a heavy and unceasing pressure to earn money, and they earned it wherever and however they could,—where it was in their power to earn it through exactions, they exacted; where they were forced to compete for it, they competed. There resulted a system of inequitable local discriminations which might not unfairly be described as intolerable. At one point several roads would converge, and the business or travel from that point would be furiously fought over and done for almost literally nothing; while other points but a few miles away would be charged every dollar that their business could be made to pay without driving it off the railroad and back into the

highway. Where goods were started from the same point to different stations upon the line of the same road, those forwarding them discovered to their cost that the tariffs resembled nothing so much as an undulating line,—for a distance of twenty miles, more would have to be paid than for one of forty miles; and not infrequently a consignee would see goods habitually carried by his door to some point miles farther on, in order that the company might charge him the local rates for bringing them back. Those living between competing points were rigidly excluded from the benefits of competition. To such an outrageous extent was this carried, that it became the common practice where an entire carload of merchandise was paid through to a competing point to make a large extra charge for *not* hauling it to that point, but leaving it at its ultimate destination, perhaps a hundred or two miles short of it. Competition led also to favoritism of the grossest description,—men or business firms whose dealings were large could command their own terms as compared with those whose dealings were small. The most annoying and injurious inequalities were thus spread all over the land. Every local settlement and every secluded farmer saw other settlements and other farmers more fortunately placed whose very prosperity seemed to make their own ruin a mere question of time. Man to man, or place to place, they might compete; but where the weight of the railroad was flung into one of the scales, it was strange if the other did not kick the beam.

Of course, even under the most favorable circumstances, such a condition of affairs could not be perpetuated. In this case, however, it was aggravated by a system of gross jobbery and corruption which, before the storm burst, seemed fairly to have honeycombed the whole railroad system of the West. It began high up in the wretched machinery of the construction company, with all its thimble-rig contrivances for transferring assets from the treasury of a corporation to the pockets of a ring. Thence it spread downward through the whole system of supplies and contracts and rolling-stock companies, until it might not unfairly be said that everything had its price. The whole story is, however, told in these two words, *Absentee Ownership;*—while the Western patron was plundered, the Eastern proprietor was robbed. Under these circumstances the continuance of the system was made even shorter than it otherwise need have been by the other cause of grievance which has been referred to,—Bad Manners.

This is a vastly more important matter to railroad corporations, not only in the West, but all over the country, than those owning or managing them appear to be aware of. In New England the condition of affairs is bad enough; and more than one important corporation has experienced great injury, or finds itself leading an existence of perpetual warfare and turmoil, solely through the inability of some prominent and, perhaps, otherwise valuable official to demean himself with consideration towards his brother man. What in this respect is seen here in the East is absolutely nothing to what prevails in the West. Taken as a class, the manners of the employees of the Western railroad system are probably the worst and most offensive to be found in the civilized world. It is difficult to see why the official should regard the traveller or the person having dealings with the railroad as his natural enemy; but it is apparent that he does. If it were an ordinary manifestation of the American fondness for asserting equality on all occassions it would be endurable; it commonly, however, partakes of a more aggressive and hostile character. A ticket is sold, and the purchaser is at the same time made to feel that a favor has been conferred upon him,—that he is on no account to ask any questions,—and, indeed, had best speedily remove himself out of the way. The gruffness of the baggage-master is, as a rule, only excelled by his violence to the baggage. Indeed, it would sometimes seem as though it must be a prominent rule laid down by the companies for the guidance of their servants, that they are to show the least possible degree of respect or consideration to any person having business with the company; and so thoroughly is this principle applied, that—always excepting Mr. Pullman's cars, in which an excellent discipline is maintained—the railroads of the West are the single institution anywhere to be found from whose servants money will not at times buy civility even of the commonest kind. I very well remember an amusing illustration of this rule which occurred to me about two years ago. One autumn day I found myself at the station at Omaha about to take the eastward train. In the baggage-room of the station I had, some hours before, left quite a heavy trunk for which I now presented my check. The sternly silent baggage-master found it, seized it, and, without a word, tumbled it out of the door at my feet and disappeared into the recesses of his lair. The train I was to take was some distance down the same platform on which I was standing, perhaps a hundred yards. I could not well carry the

trunk to it, and it seemed foolish to abandon it, especially as directly in front of me an assistant baggage-master or porter of the company stood leaning against the side of the station, chewing a straw and lazily observing me. There seemed but one short way out of the difficulty; taking out my purse, and addressing him in the most persuasive tones, I said, "Do you think you could get a truck and wheel that trunk down to the train there for me?"—at the same time suggestively fingering the purse. For an instant the gentleman addressed did not move a muscle; then, after contemplating me to his satisfaction, his mouth opened, he stopped chewing the straw, and simply uttered the one expressive monosyllable, "No";—this done, he resumed the mastication of his straw, and the conversation ceased. In that case it is fair to presume that the public had worried and annoyed the poor fellow by asking him all sorts of questions, and calling on him, even as I had, for all sorts of services; but the ingenuity of discourtesy with which he retaliated was certainly deserving of all praise, nor can I doubt that before this his merit has been recognized, and he has been promoted to the office of freight-agent, or, perchance, assistant superintendent.

The explosion of wrath and hatred against the railroad corporations which marked the progress of the Granger movement furnished abundance of evidence, if any evidence were necessary, of the all-pervading character of this description of deportment. It was encountered, probably, at every turn, and as the regular accompaniment of every transaction. It was seen in the very curt and unceremonious manner with which, some nine months since, the information was conveyed to Governor Taylor of Wisconsin that the railroad companies did not propose to pay any attention whatever to the "Potter Law." In the same spirit the officials of the roads held at arm's-length the members of the various commissions that were created. Instead of at once, in their dealings with them, taking advantage of all their familiarity with the railroad system, of all their intimate knowledge of its workings, of all their social and financial power, they ignored the existence of these boards, and thus wantonly threw away the greatest strength of their position. They apparently preferred to fight it out at the expense of their stockholders. Thus, in the dealings of the railroad corporations with the people of the West, every favor they conferred produced much the same sensation on the party receiving it as an ordinary refusal, while a refusal was apt to leave the rankling sting of an insult.

Such were the relations existing between the people of the West and the railroad corporations of the West about the year 1872. The community had got its railroad system, but it was not working in all respects as it had been supposed it would work, and those whom it was built to serve were made to realize that its ownership was in foreign hands, which held it with a view to drawing profit from it. So now, with all that intensity of feeling natural to them, this people, in place of seeing only the want of railroads, saw only the abuses incident to the management of railroads. In order to quicken construction they had rushed headlong into the wretched land-grant policy; and now the railroad companies were become monopolists and speculators, and held vast tracts of land at inordinate prices, which the settler would ultimately find himself compelled to pay. Not satisfied with this the towns and counties had been bonded, and even the private farms mortgaged to hold out new inducements to construction; and now the interest began to press, and so, what with the gradual appreciation of paper-money in value, and the results of that protective system which enriched the manufacturer at the expense of the agriculturist; and what with two or three exceptionally good years in America and as many in Russia and Hungary,—what with all these things, the Western mind was perplexed in the extreme, and looked eagerly about for something with which to find fault. Had the people been other than they were, they would probably have struck down below the mere outward aspect of things, and found the real source of their trouble in that curious combination of protection and paper-money which, through a series of years, had been regularly forcing up the market price of everything except the products of the soil. Being what they were, however, their thoughts naturally dwelt upon the one obvious fact that the product of their farms was at home worth but a fractional part of what it was worth in Liverpool, and that the other portions were eaten up in transportation. The railroad companies were far from popular, their management teemed with abuses, causes of complaint existed against them no less grave than notorious; and so the impetuous Western farmer saw only these facts, and, as his anger blazed up, he became at once deaf to reason, to law, or to considerations of remote self-interest.

So now the railroads were no longer the pioneers of dawning civilization or the harbingers of an increased prosperity; they were the mere tools of extortion in the hands of the capitalists,—the

money-changers of the East,—marauders, banditti, usurers, public enemies. The extravagant utterances of that time would seem incredible were they not recorded. For instance, here are two of a long series of resolutions adopted at the great convention of the Granges held at Springfield, Ill., on the 2d of April, 1873:—

"*Second*, The railways of the world, except in those countries where they have been held under the strict regulation and supervision of the government, have proved themselves of as arbitrary extortion and opposed to free institutions and free commerce between the states as the feudal barons of the Middle Ages.

"*Third*, That we hold, declare, and resolve that this despotism, which defies our laws, plunders our shippers, impoverishes our people, and corrupts our government, shall be subdued and made to subserve the public interest, at whatever cost."

This comparison between the modern railroad corporation and the feudal baron has in it something grotesquely absurd, but it was very popular among the Granger rhetoricians. It makes its appearance with great regularity in nearly all their more labored and ornate productions. In June, 1873, for example, numerous county gatherings put forth a declaration of farmers' grievances and principles, in which occurred this notable passage: "The history of the present railway monopoly is a history of repeated injuries and oppressions, all having in direct object the establishment of an absolute tyranny over the people of these States unequalled in any monarchy of the Old World, and having its only parallel in the history of the mediæval ages, when the strong hand was the only law, and the highways of commerce were taxed by the feudal barons, who, from their strongholds, surrounded by their armies of vassals, could levy such tribute upon the traveller as their own wills alone should dictate."

It is, however, little better than a waste of room to repeat these wild utterances; for in fact it may be briefly said that no language was found strong enough to characterize those who at that very time, under the stimulus of avarice inspired by the mania which was then sweeping over the country, were literally sinking millions upon millions in the construction of railroads which were destined to be at once monuments of Eastern folly and the source of Western prosperity. As usual, however, the wild utterances took the form of yet wilder laws. The enactment of laws was demanded which should regulate the profits, the methods of operation, and the political relations of the railroads; the corporations were to

be made to realize, as the phrase went, that "the created was not greater than the creator"; that the railroads were the servants of the people, and not their masters. Here was the complete abandonment of the whole theory of regulation by natural law, under which the railroad system of the West had been organized and had grown up. It was brought to a logical result. If that theory was worth anything at all, the remedy for the ills under which the community was suffering would at once come into play. The railroads were not monopolies. There was nothing to prevent the organization of new companies to construct parallel and competing lines of roads side by side with those already in operation, from one end to the other of every Western State. Here was the remedy through competition, and the mere statement of it revealed the utter absurdity of the whole theory which had been at the base of thirty years of legislation. The position was, in fact, a very difficult one; and its greatest difficulty lay in the fact that the remedy appeared to lie upon the surface. When natural laws break down it is apt to seem a very trifling matter to set them going once more by some little act of Legislature. In other words, if, as the Granger philosophers assert, "the created is not greater than the creator," he is, at any rate, when duly chosen to the Legislature, infinitely wiser, and the sadly bungled laws of nature are continually amended and made right through the beautiful symmetry which marks the enactments of the statute-book. In America a law is the popular panacea for every ill of the body politic,—moral, social, or economical. The faith and simple confidence in which it is applied has in it something bordering upon the sublime. Our men are made temperate by one chapter of the statute-book and our women virtuous by another; people are prevented from overworking themselves by a "ten-hour law," and kept from paying more interest than is good for them by a usury law; the amount of currency necessary to carry on the business of the country must be regulated by a legal-tender act, and the character of our industries by a so-called protective system. Our statute-books are in fact most curious and valuable monuments of the very trivial inroads which have in this department as yet been made by us as a people into the vast domain of ignorance. As a rule, they evince upon the part of our lawmakers about the same degree of acquaintance with the principles and limits of legislation, as the star-gazers of the fifteenth century possessed with those of astronomy, or the alchemists with those

of chemistry. All this was illustrated to a remarkable degree in the Granger railroad legislation. The difficulty arose from deep-seated causes; the agencies upon which the community had relied for the proper regulation of its whole system of internal transportation had broken down, and the machinery through which alone the work could be carried on was the property of aliens and foreigners. If ever a problem called for wise legislation, founded upon careful and patient study, this one certainly did. The Granger Legislatures, however, went at it like so many bulls at red rags. For three years it was useless to argue, useless to refer to experience, useless to point out absurdities or incongruities. No inquiry into the remote consequences of legislation was deemed necessary; no investigation of the hidden causes of the difficulty was tolerated; there the difficulty was, and a law such as almost any man who knew how to write at all could easily draw up in an afternoon, would, it was confidently believed, at once remedy it. Yet practically the control of the railroads was to be taken out of the hands of the owners, and was to be placed in those of the State. The arguments encountered in the discussion of this question were of the most appalling description. On one occasion I suggested to a Western man, occupying a prominent official position connected with railroad legislation, the grave doubts I entertained whether, under the shifting system of administration in use in this country, it was practicable for the government to deal with the complicated details which arose in the preparation of railroad tariffs. The answer was immediate and a veritable clincher. "Sir," said the prairie Solon, drawing himself up to his full height of six feet one and one half inches, "you will never make me doubt that a government which could put down that mighty Rebellion can regulate the details of a few tariffs of some railroad corporations!" The last previous occasion on which I remembered to have heard that argument had been when General Garfield of Ohio advanced it, with great applause, in reference to an alleged inability of the revenue officials to collect a tax of one dollar and a half per gallon on the manufacture of whiskey. Always, however, brilliant in conception,—always fresh, it is an argument which is almost certain to bring discussion to a close.

The legislative struggle was, however, soon over. Laws were passed and went into effect under which entire tariffs of charges were imposed upon the railroad corporations. These, of course, the corporations resisted in the courts, not always in the most

judicious manner, upon the ground that under the Constitution of the United States the Legislatures had no authority to practically confiscate private property by decreeing that the public might enjoy it on paying therefore an inadequate compensation, or no compensation at all if it so saw fit. On this question more will be said presently. One of the least creditable features of the Western character now, however, began at once to reveal itself,—an extreme restiveness under the restraints of law. This is a not unnatural remnant of the old frontier life, and one which is rapidly passing away; but in 1873 it is none the less an historical fact that a majority of the voters of what is beyond question the leading State of the Northwest could not and would not understand how any court of law should presume to set aside as illegal a duly authenticated expression of the popular will.

The prevalent idea in this respect, so wholly different from that which prevails in longer-settled communities, so revolting to every sense of calm, well-ordered justice, was well and tersely expressed by a witness before the Windom Committee, so called, of the United States Senate, on Transportation Routes, of 1873. The name of the witness was Samuel P. Tufts, and he went before the committee as representing the Northwestern Farmers' Convention already referred to, which held its sessions in Springfield, Ill., in April, 1873. He had expressed to the committee the opinion that Congress should enact a law limiting passenger fares to three cents per mile upon all railroads which passed from one State to another; the following colloquy then took place between Senator Sherman and himself. Mr. Sherman suggested this case:—

Question. Suppose—taking the State of Iowa—that the law of the State chartering the railroad company and inviting capitalists to build the road in the State has stipulated that they should receive five cents a mile for passenger traffic, and has made it a part of the charter. Have you considered that difficulty?

Answer. It ought to be abrogated and wiped out.

Qu. Have you ever considered the difficulty of abrogating it, under the Constitution of the United States?

Ans. There are different views of that. We hold, and that position is generally advocated by the farmers in the West, that all power rests with the people, and that they can remodel all laws which are made to affect them; and that the law of Congress that was passed in the interests of the people, which comes in contact with charters that have been adopted even under the provisions of the Constitution, would receive the support of the people and be sanctioned by popular approval.

Qu. I am not speaking now of the law of Congress; but suppose the law of the State has prescribed a fixed rate, and the Constitution of the United States declares that no State shall impair the obligation of a contract?

Ans. They must alter their law. I do not apprehend that the contracts ought to be binding.

Qu. The difficulty is, suppose that Congress should undertake to change the law, and the Supreme Court should declare it to be unconstitutional under that provision?

Ans. Then do as they did in the Dred Scott decision. Wipe the Supreme Court out and get one that would decide it.

Qu. We are all in favor of cheap transportation, but we desire to see the difficulties in the way of legislation. You would, then, reverse the decision of the Supreme Court by the popular will?

Ans. Yes, sir.

Now, in thus expressing his views, Mr. Tufts not only said what he himself believed, but he described nothing more than had more than once in the Western States actually been done, and that, too, on questions affecting the rights of railroad corporations. It is not so very many years ago that a popular contest, which excited fully as much feeling locally as the Granger movement has over a wider field, raged in the West on the question whether railroad corporations had or had not a purely private character; because, if they were purely private, then the municipalities were unauthorized to appropriate to their use the public funds, and the bonds which had been issued in aid of these enterprises had been issued without right, and constituted no debt collectible at law. In plain English, it was a move for practical repudiation under cover of a technicality, the point being that the authorities had exceeded their power in appropriating public money to private uses. The courts held that the railroads were quasi public corporations, and that the bonds issued by towns and counties in aid of their construction were a valid debt against the localities which issued them. Not pleased with this decision, the people of certain of the Granger States proceeded to, and actually did, reverse it by the process of electing, in the place of the judges then upon the bench, other judges pledged to a different construction of the law. The bench was thus packed, and this packed bench rendered a decision which is subsequently referred to in an opinion of the Supreme Court of the United States as "standing out in unenviable solitude and notoriety;"—and recognizing the ingenuity of the self-stultification, the opinion of the Supreme Court was concluded with this stinging and well-merited rebuke: "We

shall never immolate truth, justice, and the law, because a State tribunal has erected the altar and decreed the sacrifice."

Now, however, the whirligig of time had brought its revenges, and it had ceased to be convenient to consider railroads as purely private corporations. It was necessary for their regulation that their public character should undergo development, and the Granger was fully equal to the occasion. In the early part of the year 1873 a case was brought before the Supreme Court of Illinois, which involved the constitutionality of the acts under which the Legislature had sought to impose tariffs of specific charges upon the railroad companies. The decision of the court was unanimous, and in undoubted accordance with the law. The opinion was prepared by Chief Justice Lawrence, who, while pronouncing the legislation, as it then stood, unconstitutional, at the same time went out of his way to point out the very simple process through which the defects in it could be remedied. None the less this decision gave great offence to the Grangers, and they proceeded to formulate their objections to it. While their conventions resolved that "the doctrine of vested rights belongs to a past age and despotic rule, and has no legitimate place in the jurisprudence of a free people," their leading authorities enlarged upon the text, and one of them, a certain Dr. M. M. Hooton, of Centralia, Vice-President of the Illinois State Farmers' Association thus publicly stated the issue as tersely as his brother Vice-President Tufts could have done:—

"What, then, do the farmers complain of?

"*First,* They believe that this court, honest as it is, is about a hundred years behind the business and people of this country.

"*Second,* The court attempts to rule the country, regardless of the wishes of the people; usurping the right to make the dictum of the court the law of the land, no matter what the wishes of the people may be."

The Illinois Grangers, however, did not by any means stop with empty denunciations; on the contrary, they proceeded at once to evidence their faith by works. It so happened that the term for which Chief Justice Lawrence had been chosen to the bench expired at about this time. Accordingly, on the first of May succeeding the publication of the opinion in the railroad cases, a nominating convention was held at Princeton, Ill., which first proceeded to revise the law of the Chief Justice, and then to select another man to succeed him on the bench. The resolves of

this and of other similar nominating conventions at about the same time are curiosities, and deserve to be perpetuated as materials to serve in the preparation of some future history of the elective judiciary. The opinion of the court to the contrary notwithstanding, it was declared that railroad charters were not contracts at all, and that the Illinois legislation was constitutional, and that the judiciary ought to decide it to be so. Difficult points of constitutional law were thus disposed of in town meeting, and candidates for the ermine were called upon to pledge themselves as to how they would decide cases involving the rights of numberless private persons, in advance of all argument, and as a condition of their promotion to the bench. At the election in June, 1873, Chief Justice Lawrence was defeated by a heavy popular majority, though generally supported by the bar of his district, and a Mr. Craig was elected in his place. Had they cast about them with all the ingenuity of perversity, the Grangers could not have devised a worse, a more fatal blow at all effort at well-considered railroad reform. Americans are not wont to be sparing of their denunciations when, in the history of other and darker days, they find the scales of justice weighted down either by the hand of a despot or the sword of a tyrant. It may well be questioned, however, whether in the whole history of modern civilization there can be found a parallel to the Illinois bench-packing of 1873, whether as respects its outrageous disregard of all considerations of decency or the brazen brutality with which it was done;—which, indeed, carried with it the single defence of which the transaction admitted, that those concerned knew no better.

There is, however, one point in connection with all the legal proceedings that sprang out of the Granger legislation which is deserving of more notice than it has received. The corporations uniformly fell back on their constitutional guaranties; and these guaranties apart, it seemed to be conceded on all sides that railroad companies had no rights which legislative majorities were bound to respect. In Illinois the corporations sought shelter behind the Constitution of the United States and the decision in the Dartmouth College case. It may well be questioned whether their position would not in every respect have been far better for them had they been compelled to defend themselves through the merits of their cause. In Wisconsin the circumstances were different; a constitutional provision there exists securing to the Legislature of the State a power of altering, amending, or repealing all charters.

The effect of this clause apparently is to restore to the Legislature of Wisconsin full parliamentary powers within certain limits,—powers as ample as those possessed by the British Parliament. Unfortunately, however, as the recent railroad legislation of that State seems to show, our legislators have become demoralized through the custom of looking only to written constitutions for a restraint on their action; and, when the restrictions in those instruments are removed or cease to apply, they fail to realize that others are still effective. In a civilized community the precepts of common honesty are surely entitled to some respect in and by themselves. The earliest constitution, whether of Illinois or of Wisconsin, is young beside the great commandment, "Thou shalt not steal!" The action of the Granger Legislatures of those States has, however, more than once pressed hard upon it, and that, too, upon the averred ground that there was nothing to the contrary in the Constitutions of the States. It is certainly not flattering to our national pride, nor conducive to a renewed faith in written constitutions, to reflect that much of the recent Illinois and Wisconsin railroad legislation would have been indignantly thrown out of Parliament, not as being contrary to any provision of a written code, but for the simple and obvious reason that it was opposed to common right, to common decency, and to common-sense.

Apart from questions of discrimination and those relating to the local management of their railroads, the Granger agitation was based upon two hypotheses, neither of which will bear a close examination. The first of these was that the West was paying to the corporations owning its railroads an inordinate profit on the work of transporting its products to the seaboard; and, second, that these profits were made necessary to pay dividends upon an exorbitant and fictitious cost of the roads. The first proposition generally took the form of a statement, more or less correct, as to the proportion borne between the value of a bushel of corn in the West and the cost of transporting it to a market at New York; in general terms it would be said that of five bushels of corn, four were taken by the railroads as the price for carrying the other one to a market. This may perfectly well be true, and yet signify absolutely nothing. Before finding fault with what is paid for a service, it is desirable to know what the service is;—what, in this case, was the distance of the market? As a matter of course there must be a point somewhere to which transportation

would cost more than the entire worth of the article transported, especially if that article should chance to be heavy and of small intrinsic value. The transportation-tables which have long been in use show that upon a common earth road corn of the ordinary value can be carried only 165 miles before its whole money-worth will be consumed in the cost of its transportation. By rail, however, it can be carried some 1,650 miles. Because it can be carried this much greater distance, it is manifestly absurd to claim that there is no limit to which it may *not* be carried before that result should be arrived at; the only question is whether it is carried a proper and reasonable distance. On this point the Granger authorities have never met the statistics presented by the railroad corporations, and, indeed, it is not easy to see how these could be met. Under the stress of competition over great distances, it would be found that, as respects this class of business, the usual and obvious result had been arrived at,—that peculiar description of merchandise is carried at less than cost, and something else has to make good the loss incurred upon it.

Neither are the Granger authorities more fortunate in their second proposition, that the extortionate charges of the railroad corporations are made necessary in order that dividends or interest may be paid upon an excessive and wholly fictitious cost of the railroad system. The case is thus stated by the Hon. William M. Springer of Illinois, a leading Granger authority, in a widely circulated speech: "The railroad debt inflation amounts to over $15,000 per mile. Interest and dividends on this sum in Illinois alone at eight per cent will amount to $7,600,000 annually. This is just as much a charge upon the people as if they were Illinois State bonds. The interest and principal are alike demanded of the producers of the State." Here is an emphatic and plausible statement. What are the facts in the case? They are curiously, even ludicrously, at variance with the proposition. The indignant Mr. Springer was speaking of the State of Illinois, and the official returns of that State were probably not inaccessible to him. Illinois is essentially *the* railroad State of the Union; railroads made it, and the superb system of roads which make their returns to its commissioners include a larger aggregate mileage than any other state in the Union can boast of, not even excepting New York; the total is no less than 13,462 miles, one sixth part of all the railroad system of the United States, and a twelfth part of that of the whole world. The proposition is that $15,000

of fictitious securities, representing no investment actually made, have been issued on which the community is obliged to pay interest which he computes at eight per cent, and the binding character of which upon the people he asserts to be practically the same as that of Illinois State bonds. The statistical tables to be found in the report of the Illinois Commissioners for 1874 show the aggregate cost of construction of all the railroads included in them to be $636,000,000 upon which net annual earnings to the amount of $30,570,000 are reported,—a trifle, it will be noticed, over 4.8 per cent; a rate of interest but little more than half of that alleged, and a very materially lower rate than that required on Illinois State bonds. The other part of the statement was that every mile of the amount of railroad returned was represented by at least $15,000 of fictitious securities. If, therefore, this sum is deducted, it will on the whole aggregate of the mileage amount to no less than $202,000,000, reducing the capital account to $434,-000,000. Upon this reduced amount—the dry, waterless residue of the investment—the entire net earnings represent an annual return of exactly seven per cent!—results somewhat at variance with those evolved from their inner consciousness by the Granger economists.

Tried by this killing test, Illinois, however, shows better than any other of the Granger States. Their statistics, indeed, are curiosities when examined in a fresh memory of the railroad mania and the Granger agitation. The Wisconsin returns include 4,686 miles of railroad, of which 2,360 are within the limits of the State. The cost of these roads is reported at the not unreasonable amount of $157,000,000, or $33,000 per mile; certainly sums calculated to excite comment only because of their moderation. Upon this reported investment the annual net earnings ($6,735,-000) represent a modest return of 4.3 per cent. Fearlessly, however, following out the hard rule applied in the case of Illinois, and striking off $15,000 a mile as fictitious values from the very reasonable figures just stated, we find the cost reduced to an average of $18,000 per mile,—a result utterly preposterous. Even upon that, however, the net earnings of the system represent an annual profit not exceeding eight per cent. Wisconsin, too, be it remembered, is the State whose Legislature, by the enactment in 1874 of the most ignorant, arbitrary, and wholly unjustifiable law to be found in the history of railroad legislation, reduced the freight tariffs of its railroads twenty to fifty per cent. It is the governor

of Wisconsin, also, who, in 1875, is unable to find words sufficiently strong in which to repel the imputation that the people or Legislature of that State are actuated by any feelings towards foreign investors other than those of the purest and strictest justice! Governor Taylor evidently has little of the humorist in his composition; but there is a familiar couplet from an old English play which the unfortunate foreign investor might well and ruefully suggest for his prayerful consideration:—

> "Perhaps it was right to dissemble your love,
> But—why did you kick me down stairs?"

Turning next to Minnesota, we find that State returning on August 31st, 1873, 1,900 miles of road at a nominal cost of $121,589,000. Dealing in round numbers, and reducing this aggregate to $47,000,000, or $25,000 per mile of completed road, the people of Minnesota pay those making the investment as nearly as can be ascertained the almost bashful annual return of three per cent upon this condensed, waterless result. Taking now the tables in Poor's Manual, in the absence of any more trustworthy guide, we find Iowa credited with 2,734 miles of road, represented by $96,000,000 of securities, and thus not charged with a cost exceeding $35,000 a mile; upon this the net earnings of the system represent an annual return of about four per cent. Again, throwing out the $15,000 per mile of fictitious values, and so reducing the cost of this system to the low standard of $20,000 per mile, we find that upon this reduced valuation the entire net earnings are equivalent to an annual return of only seven per cent. Kansas is credited with 2,215 miles of road, represented by a capital of $118,000,000. An unusually large proportion of this is fictitious, and for that reason it would be safe to throw out of the account, not $15,000, but $30,000 per mile; and yet, even with this liberal deduction, it will be found that the people of Kansas annually pay a profit of but six per cent on the capital invested in their means of transportation.

Here, then, are the five great Granger States,—those in which the cry against the unfeeling extortions and the inordinate profits of the railroad "monopolists," "Shylocks," "marauders," "banditti," "feudal barons," and "tyrants" has rung out loudest and longest; yet what are the conclusions to be drawn from the returns? Those returns include 25,000 miles of railroad. It may be objected that a portion, and no inconsiderable portion, of this

amount enters more than once into the total. That fact, however, does not affect the results, as the securities, the discounts, and the earnings all enter into the computations in the same degree. These 25,000 miles of road are represented by $1,130,000,000 of paper securities, upon which the net earnings of the system equal, not eight per cent, but just half of that amount, four per cent. Casting out of this great aggregate thirty-six per cent of fictitious capital, reducing it at once by $16,000 per mile and by a grand total of $400,000,000 to a dry, waterless basis, we find that the aggregate of the net earnings represent an annual return of just 6.5 per cent on the investment. This certainly is neither usurious nor oppressive. Six and one half per cent on the reduced cash capital is a very different thing from eight per cent on the inflated capital; yet Mr. Springer goes on, in the torrent of his indignant denunciation, declaiming against the wrongs under which his people suffer, and in the next breath declares that, though they will not submit to a continuance of the existing system of charges, yet "railroad tariffs that would pay reasonable running expenses and seven per cent on the actual cost of the roads and equipment would be cheerfully paid by all the people." Under the Granger process of reasoning, therefore, it would appear that 6.5 per cent is an outrageous extortion to be resisted to the bitter end, while seven per cent is a reasonable profit to be cheerfully paid!

The simple truth is that the Granger authorities, as respects the construction of railroads, gravely suggest a most plausible arrangement, the innate absurdity of which they do not themselves seem to appreciate. In plain language, they wish others to take all the risk, while they are to retain the entire excess of profit, which was the inducement for which that risk was incurred. In other words, the construction of railroads in the West is found by experience to be a most dangerous business to engage in. The average profit on the actual investment hardly exceeds five per cent per annum, and the Granger States alone are now enjoying the use of some $200,000,000 of foreign capital, recently invested in the construction of their railroads, upon which they do not pay one dollar of interest, while a very large proportion of the principal is being swept out of existence through bankruptcy. Under these circumstances all their authorities—their governors, their commissioners, their legislators, their orators, and their political conventions—indignantly deny that the people of those States wage any war on capital. They also unite, as with one voice, in

declaring the universal willingness to pay a reasonable profit on the real cost of the railroads; but when pressed to explain what is meant by the phrase, "a reasonable profit on real cost," it uniformly appears that they understand it to mean a reasonable profit in cases of success and nothing at all in cases of failure; they by no means propose to allow the system to average itself, nor do they understand that under any circumstances they are ever to be called upon to pay more than a fair interest, and where no interest is earned—that is none of their concern. As the Railroad Commissioners of Illinois very fairly and bluntly state in their last Annual Report: "There is for the business of railroading no more a royal insurance company, guaranteeing a fair return upon any and every investment made therein, than there is for any other business." It is very questionable, however, whether the gentlemen who made this statement will accept its other and necessary consequence. Certainly if the principles of a reasonable limit on profit and no guarantee against loss could be combined and made practically effective, it would be a most admirable arrangement for any community which was so fortunate as to find any one ready to construct its railroad system upon it. After all the losses on the bad investments have been charged, and all the profits on the good ones reduced to what might, in these individual cases, seem "reasonable," the statistics show that the average interest paid on the entire investment would not exceed two per cent per annum. Unfortunately the plan labors under a very serious difficulty,—innate absurdity. That it should at this late day be coolly and seriously proposed by reasoning beings is truly a matter for wonderment. There is no business, there is no form of investment on earth upon which the calculations of the market-place do not work out an average, making the profit offset the losses. A low rate of interest implies a perfect security, a practical guaranty against loss; a high rate of interest indicates an unusual risk with no assurance against loss. If the Granger States of the West will guarantee to those constructing their railroads a fair and reasonable interest on the capital actually invested in them, they can undoubtedly on those terms secure all the capital they need; probably not at so low a rate (five per cent) as they now enjoy it; but still upon terms sufficiently favorable. If, however, they do not propose to offer any guaranty, to establish any "royal insurance company," but do propose to leave investors to take their own risks, they must then make up their minds to one of

two things,—they must either let the successes offset the failures, or they must go without their railroads. Neither in Illinois nor in Wisconsin, nor anywhere else in the world, will persons of ordinary prudence invest their capital in a notoriously unsafe form, in which losses may be total, while profits can only be reasonable. Hitherto, through the wretched expedients of railroad financiering, and in utter disregard of ridiculous statutes, a rough average of not unreasonable profit has worked itself out, and the development of the railroad system has gone on. The "heads-I-win, tails-you-lose" basis of future construction, now with such indescribable gravity propounded from the Northwest, may excite a grim amusement in the money markets of the world, but that any railroads which involve a risk of loss will be built under it is more than improbable. Somehow or in some way, the man who builds the road will insist upon his guaranty against a loss, and he will have it.

It is difficult, therefore, from anything which can be found in the statistics upon the subject to avoid the conclusion that, though the States of the Northwest got their railroad systems at a very high nominal cost, yet they paid for them largely in the most worthless of paper securities; and that the real cost, after the slow process of liquidation has worked itself out, will prove to be not only actually reasonable, but even considerably less than it would have been had the investment been guaranteed by the State governments. It would also seem that the people of those States have no just cause of complaint as respects the cost of moving their products to the seaboard. There, at least, competition has produced every result which even the most sanguine could have anticipated from it. What, then, has been the real underlying, hidden cause of this widespread agitation?—was there any, or was it, after all, a mere restless surface movement? The real cause of complaint, the true source of the evils under which they suffer, has as yet received but little mention among Western men; in fact, the subject is one the discussion of which they instinctively avoid, for there are no votes in ugly truths. Though the source of all their woes is not apparent on the surface, it may be described in very few words,—*they have gone too far West*. For this they are themselves chiefly, though not wholly, responsible. The West has ever proved itself the steady, reliable ally of that wretched land-grant and subsidy policy which did so much to stimulate the mania for railroad construction. For years the ruling idea

of the Western mind has been the bringing of remote acres, and ever acres more remote, under cultivation. There was thought to be some occult virtue in expediting this process,—a service to God and one's country. Every artificial appliance and inducement was thus set to work to force population out in advance of the steady and healthy growth of civilization into regions beyond the reach of the world's centres and outside the pale of social influence. It was this hurtful forcing process which brought about that condition of affairs which had to culminate in the Granger movement, and in the organized assault on property in railroads. The people were paying the penalty of too rapid growth,—paying it just as much as any boy or girl must pay it who is so unfortunate as to outgrow strength and clothes at once.

The result brought about by the unnatural diffusion of population, so far as the agricultural interests of the West were concerned, was exactly what any thinking and observing man should have anticipated,—over-production at remote points. This difficulty no increased cheapness of transportation can alleviate; it can only transfer the locality of the difficulty to a point somewhat more remote. The darling vision of the Granger's dreams, the Utopia of his waking fancies, and the constant theme of his noisy rhetoric, is a double-track, steel-rail, government-built, exclusively freight railroad from every farmer's barn-door straight to the city of New York. Paradoxical as it may seem, there is not the slightest room for doubt that even the full realization of this fanciful impossibility would not at all benefit the individual farmer of the West. It would fail to benefit him for a very simple and obvious reason. The difficulty he is now laboring under is over-production; the West grows more of the fruits of the soil than the world will consume at present prices. Meanwhile the area from which production is possible is not only not fully occupied, but is for all practical purposes unlimited. A reduction of the present cost of carriage, therefore, only serves by so much to extend the area from which the supply can be drawn, brings so many additional acres and so many more farmers into the field of competition. The whole benefit of the reduction inures, therefore, not to the producer, but to the consumer. The new-comers glut the market before it can be relieved. Any reduction in the cost of the carriage of agricultural products is, therefore, of enormous importance to us on the Atlantic seaboard, and of yet more importance to the swarming population of the British isles,—to the competing

agriculturists of Eastern Europe it involves also most serious consequences,—but to farmers of the West, as a class, it amounts to nothing more than one additional step in continuance of that same progress which has steadily been going on for over thirty years, and which they now claim has brought them to their present hard and desperate pass. Ever since 1830 the cost of transportation has been growing cheaper and cheaper, until it has now touched points which would have been considered incredible; yet the standing complaint of the farmer is still that the cost of carriage consumes the whole value of his product; just as much so to-day, when the limit of its carriage is sixteen hundred miles, as fifty years ago when it was but one hundred and sixty miles.

The Granger movement touches, then, the real cause of the evil under which the West is suffering only so far as it tends to supplement the disasters of the recent financial crisis and put a complete stop to all further immediate railroad construction. In this way it may help to hold in check the existing tendency of population to diffuse itself prematurely, and restore the country to a healthy, because more measured process of development. This, however, is a result which its leaders and would-be philosophers have not contemplated, and which partakes, indeed, somewhat of a boomerang character. They may, however, yet learn that what we need is not always that which is pleasant to get, and that we sometimes build more wisely than we know. Meanwhile the recent halting and confused action of the legislatures of the Northwest makes it apparent enough that the Granger flood is reached, and that the ebb will soon follow,—the movement is now obviously losing its strength. Though it accomplished little that it intended, it has yet, unconsciously to itself and through that rough process of attrition by which most results that are valuable are brought about, removed or greatly modified those more superficial grievances which gave it its only popular strength. It has placed many preposterous laws on the statute-books of the West, which will probably long remain there, undisturbed memorials of legislative incapacity, and about as formidable as those ancient blunderbusses which sometimes in old-fashioned houses ornament the kitchen wall. Undoubtedly it has seriously impaired the credit of those States more especially identified with it, and notably that of Illinois and of Wisconsin. For this, of course, they will have to pay dearly;—higher interest and more binding guaranties will unquestionably be exacted of them, and, what is

more, they will have to give them. Habitual borrowers cannot afford to play tricks with their credit, and it will be very long indeed before either the defeat of Judge Lawrence or the provisions of the "Potter Law" are forgotten in Wall Street or on the Royal Exchange.

In some respects the results produced by the movement have been most beneficial. The corporations owning the railroads have been made to realize that those roads were built for the West, and that, to be operated successfully, they must be operated in sympathy with the people of the West. The whole system of discriminations and local extortions has received a much-needed investigation, the results of which cannot but mitigate or wholly remove its more abominable features; finally, certain great principles of justice and equality, heretofore too much ignored, have been driven by the sheer force of discussion, backed by a rising public opinion, into the very essence of the railroad policy. All this is much gained. The burnt child fears the fire, and the Granger States may rest assured that, through an indefinite future, the offensive spirit of absentee ownership will be far less perceptible in the management of their railroads than it was before and during the great railroad mania. Finally, East and West, the good which has resulted and yet will result from the Granger movement will be found greatly to predominate over the evil; what is more, the good will survive, while the evil will pass away.

CHAPTER XXX

EVOLUTION OF FEDERAL REGULATION OF INTRASTATE RATES [1]

"Powerful and ingenious minds, taking as postulates that the powers expressly granted to the government of the Union, are to be contracted by construction into the narrowest possible compass, and that the original powers of the States are retained, if any possible construction will retain them, may, by a course of well-digested but refined and metaphysical reasoning founded on these premises, explain away the constitution of our country, and leave it a magnificent structure, indeed, to look at, but totally unfit for use."

"By virtue of the comprehensive terms of the grant the authority of Congress is at all times adequate to meet the varying exigencies that arise, and to protect the national interest by securing the freedom of interstate commercial intercourse from local control."

The first quotation is from Chief Justice Marshall's opinion in *Gibbons* v. *Ogden,* the great pioneer decision that defined the commerce clause of our Constitution. That opinion was rendered in 1824. That was ninety years ago. The second quotation is from Mr. Justice Hughes' opinion in the so-called Shreveport Rate Cases decided last June [1914]. In the one case, Chief Justice Marshall declared that the State of New York could not grant a monopoly in the use of its navigable waterways. In the other, Mr. Justice Hughes declared that the State of Texas could not maintain rates of transportation, however reasonable in themselves, between points within its boundaries, if these rates were discriminatory against rates ordered by the Interstate Commerce Commission to be maintained between points within and points without the State of Texas. The one decision purports to be warranted by the other.

The language of the two quotations differs only in phraseology.

[1] From William C. Coleman, "The Evolution of Federal Regulation of Intrastate Rates: The Shreveport Rate Cases," *Harvard Law Review*, vol. 28, pp. 34–81 (November, 1914). Reproduced by permission. See Jones, pp. 199–209, 553–554, 569–570, and Vanderblue and Burgess, pp. 46–55.

The meaning intended to be conveyed is the same in both. They both affirm in absolutely definite terms the paramount authority of Congress over interstate commerce. Therefore to the lay mind, and indeed to those lawyers who have not undertaken a close study of the development of our constitutional law through judicial interpretation or judicial amendment (and for the purpose of our subject, of course, it is only with judicial interpretation and judicial amendment that we are concerned, because the commerce clause has thus far escaped all direct modification), it would seem that the construction placed upon this, the most vital clause of our whole Constitution, is no different from the construction placed upon it by the remarkable prescience of Chief Justice Marshall at the time when the Constitution was still in its infancy and railroads, and therefore railroad rates, were things unknown. But is it true that the construction is the same? This question is not capable of an absolutely conclusive answer for the obvious reason that Chief Justice Marshall could not foresee, and therefore his definition cannot be said to apply without qualification to, present-day conditions. This is said, of course, with full appreciation of the well-established principle that the reasons which may have caused the framers of the Constitution to repose the commercial power in Congress, and upon which our early justices necessarily largely relied, do not limit the extent of the power itself. Whether Chief Justice Marshall, were he living to-day, would reason as do the members of our present court is a matter of the purest conjecture; but even assuming that he would, the all-important fact remains that during this long period of ninety years agreement has by no means prevailed in the opinions expressed by the Supreme Court from time to time upon the scope of the commerce clause. An analysis of the opinions in the various cases shows widely dissimilar views. Here we will find an expansion of the commerce clause, there a contraction. Each view has a certain historical or economic significance. That there is this variance is by no means unusual. It is but the evolution of this branch of our constitutional law. The questions of police power, taxation, due process and equal protection of the laws, not to mention innumerable other questions, have each, in their turn, been subjected to a similar process of development. These evolutions have been largely constructive, not destructive. They represent a progressive trend of thought, and yet one ever mindful of our government's constitutional limitations. In some cases there were no such convincing

precedents as those dealing with the commerce clause upon which to build. Occasionally precedents have been overruled expressly, because found to have been clearly erroneous, or impliedly, because of the stress of economic conditions,—nullification by indirection, if you will. But, for the most part, there has been a more or less successful attempt to square the latest decisions with the fountain heads that have gone before. To this general rule, however, the evolution of the commerce clause, in so far as it relates to the regulation of intrastate rates, is believed to be an exception, and it is the purpose of this article to trace this evolution by an analysis of the decisions which have brought it about.

The evolution of federal regulation of intrastate rates is properly to be traced by dividing the decisions construing the power of Congress over interstate commerce into five periods, each of which is more or less distinctly defined by reason of particular interpretations placed upon the commerce clause. The first period dates from the adoption of the Constitution in 1789 to 1829. This period is noteworthy in that it evolved these two basic principles: First, that the actual regulation of interstate commerce by Congress excludes its regulation by the states. Second, that the power to regulate purely internal commerce rests exclusively with the states regardless of whether they actually exercise this power or not. This period will be called the Constructive Period.

The second period dates from 1829 to 1876, the year of the so-called Granger Cases.[1] This period is noteworthy in that in addition to upholding the two basic principles of the first period, it gradually evolved, although not without great controversy, a third basic principle, namely, that in matters essentially national in their nature and requiring uniformity of regulation the exclusiveness of congressional power is not dependent upon actual exercise of that power, but arises from the very grant itself of the power; while in matters which, though affecting interstate commerce, are primarily of local interest, the power of the states to regulate is plenary in the absence of congressional action. This latter power is generally, though it would seem rather inaccurately, described as concurrent. The use of the word "concurrent" rather conveys the idea of simultaneous operation of the state and the federal power, whereas the one operates only when the other is not exercised.

[1] *Munn* v. *Illinois*, 94 U. S. 113; *Chicago, B. & Q. R. R.* v. *Iowa*, 94 U. S. 155; *Peik* v. *Chicago & N. W. Ry. Co.*, 94 U. S. 164; *Winona & St. Peter R. R. Co.* v *Blake*, 94 U. S. 180.

From the fact that the state power is dominated by, and must give way to, the federal power when exercised, it would seem perhaps more accurate to speak of the one power as *dominant* and of the other as *servient.* This second period will be called the States' Rights Period.

The third period, one of only ten years, dates from 1876 to 1886, the year of the decision in the case of *Wabash, St. L. & P. Ry. Co.* v. *Illinois.*[1] The decisions of this period are noteworthy in that they further extend the principle of so-called "concurrent" power to the point of saying that until Congress acts the states themselves may even regulate matters essentially national in their nature, namely, interstate rates, as well as those matters primarily of local interest. This period will be called the Extreme States' Rights Period.

The fourth period dates from 1886 down to but not including the so-called Minnesota Rate Cases,[2] decided in 1913. During this period the decisions affirm the three principles enunciated in the first and second periods, and repudiate the Extreme States' Rights principle of the third period. This fourth period will be called the Federalistic Period.

The fifth and last period dates from the decision rendered in 1913 in the Minnesota Rate Cases to the present time, and therefore includes the decision in the Shreveport Rate Cases [3] rendered last June. This period is noteworthy for the further and hitherto unknown restriction of state power. A principle never before announced is now evolved to the effect that state regulation of local rates is exclusive only until Congress acts, or, in other words, that the power of the state is servient not merely in local matters affecting interstate commerce, but in the regulation of its own internal commerce as well. In short, it does not allow the corresponding usurpation to the federal government that was allowed to the states during the third or Extreme States' Rights period, that is, regulation of intrastate rates until the states themselves regulate them, for of course that would be valueless; but it goes further and proclaims that there may be regulation of intrastate rates by Congress to the exclusion of state regulation whenever Congress may see fit to act. In addition, with the Interstate Commerce Commission, an agent of Congress, be it noted, is primarily vested the determination of this fundamental constitutional question, namely, whether state action is to be excluded;

[1] 118 U. S. 557. [2] 230 U. S. 352. [3] 234 U. S. 342.

or, in short, whether the commerce clause has been violated. This last period will be called the Period of Judicial Amendment, so radical is it in its extension of the doctrine of national supremacy. The leading decisions of each period will now be considered. . . .

III. The Extreme States' Rights Period

We have now traced the development of the commerce clause in the light of the leading cases up to approximately the year 1876. In that year began what may properly be known as the Extreme States' Rights Period in so far as the commerce clause is concerned, because it is noteworthy as the date of a number of cases which announced a principle hitherto unknown and exceeding in the extension of state power all principles that had previously been announced. The cases are: *Munn* v. *Illinois, Chicago, B. & Q. R. R.* v. *Iowa, Peik* v. *Chicago & N. W. Ry. Co.*, and *Winona & St. Peter R. R.* v. *Blake.* The question in each of these cases was, briefly stated, whether the authority of the state to limit by legislation the charges of common carriers within its borders was confined to the power to impose limitations in connection with grants of corporate privileges. The court held not, and declared that the carriers were subject to legislative control as to the amount of their charges, except when protected by contract with the state. The question was presented by acts of the legislatures of Illinois, Iowa, Wisconsin and Minnesota, passed in the years 1871 and 1874 in response to a general movement for a reduction of rates. The section of the country in which the demand arose was to a large degree homogeneous and one in which the flow of commerce was only slightly concerned with state lines. This section had begun to feel the reaction and possibilities of development following the Civil War. In the first of these cases, *Munn* v. *Illinois*, the court did not have before it railroad rates, but grain elevator charges in Chicago. Through these elevators the grain from seven or eight western states was accustomed to pass *en route* to the East. Besides denying the state's legislative authority to limit these charges, it was urged that the act of Illinois violated the commerce clause. But the court, through Chief Justice Waite, in an opinion replete with learning, and notable for its extension of the doctrine of "public interest," declared otherwise. In the Munn Case, and also in each of the railroad cases that followed, the court decided that intrastate rates were a matter purely of state concern. Had the decisions rested here there would have been nothing unusual

about them, but in the railroad cases the opinions went further, and declared that not only may a state regulate the purely intrastate business of a railroad, but that until Congress acts in reference to its interstate rates, the state may regulate them also. The expressions of opinion in each case on this point are short and admittedly received but little consideration, and have to a large extent therefore been considered as dictum. But assuming this to be true, since they have recently been adopted, as we shall presently see, as the basis for a most radical principle, the inevitable consequences of their announcement are too far-reaching to permit of mere superficial comment. Let us consider the exact words in each case bearing upon this question of state regulation of interstate rates.

In *Chicago, B. & Q. R. R. Co.* v. *Iowa*, the court said through Mr. Chief Justice Waite, "It [the railroad] is employed in state as well as in interstate commerce, and, until Congress acts, the state must be permitted to adopt such rules and regulations as may be necessary for the promotion of the general welfare of the people within its own jurisdiction, even though in so doing those without may be indirectly affected."

In *Peik* v. *Chicago & N. W. Ry. Co.* the Chief Justice again spoke as follows:

> "The law is confined to state commerce, or such interstate commerce as directly affects the people of Wisconsin. Until Congress acts in reference to the relations of this company to interstate commerce, it is certainly within the power of Wisconsin to regulate its fares, etc., so far as they are of domestic concern. With the people of Wisconsin this company has domestic relations. Incidentally, these may reach beyond the state. But certainly, until Congress undertakes to legislate for those who are without the state, Wisconsin may provide for those within, even though it may indirectly affect those without."

In *Winona & St. Peter R. R. Co.* v. *Blake* the Chief Justice rendered merely a very short opinion for the court and stated that the case fell directly within the court's ruling in the cases just considered.

This new principle was not to survive long, for in 1886 the court had occasion to consider in a very important case the revolutionary effect that the language of the Granger Cases, if sustained, would necessarily have upon the power of Congress to regulate interstate commerce. As we have seen, in the second or States' Rights

Period, which began in 1829 and ended in 1876 with these cases, the principle was developed of a dormant congressional power in local matters which when exercised meant the exclusion of state power from the same subject, but never had any of the cases gone to the extent of saying that in matters the regulation of which from their very nature rested in Congress, the state could interfere in the absence of Congressional action. In short, the Granger Cases represent not simply an extension of the principle of concurrent power finally established by the case of *Cooley* v. *Board of Wardens,* but amount in effect to an overruling of that first and fundamental principle which we found to have been foretold, if not actually established by *Gibbons* v. *Ogden*, namely, that the power of Congress in those matters requiring uniformity of regulation because national in their nature was exclusive from the very grant of the power, and was not dependent upon actual exercise of the power.

IV. The Federalistic Period

It was in *Wabash, St. L. & P. Ry. Co.* v. *Illinois* that the court hastened to retract from its position maintained in the Granger Cases, and while emphatically maintaining that there was no question of the state's authority to regulate rates for transportation wholly intrastate, such authority went no further. In this case there was before the court a statute of Illinois which enacted that if any railroad company should charge or receive for transporting passengers or freight of the same class within the state the same or a greater sum for any distance than it did for a longer distance in the same direction, it should be liable to a penalty for unjust discrimination. The defendant railroad made such discrimination in regard to goods transported from Peoria, Illinois, and from Gilman, Illinois, to New York, charging more for the same class of goods carried from Gilman than from Peoria, the former being eighty-six miles nearer to the city of New York than the latter, this difference being in the length of the lines in the State of Illinois. The court held the statute invalid as a regulation of interstate commerce. Mr. Justice Miller, in delivering the opinion of the court, expressed some doubt as to whether the Illinois court's construction of the statute was correct in making it apply to commerce among the states, but said that the Supreme Court was bound by that construction.

Continuing, he explained that of the members of the court who

had concurred in the dictum of the Granger Cases, there being two dissentients, but three remained, and that he, as one of them, was prepared to take his share of the responsibility. Then, after a thorough, analytical discussion of various cases that had been decided since the Granger Cases, showing the radical language of the latter to have been at least indirectly repudiated, the court concluded:

"We must, therefore, hold that it is not, and never has been, the deliberate opinion of the majority of this court that a statute of a state which attempts to regulate the fares and charges by railroad companies within its limits, for a transportation which constitutes a part of commerce among the states, is a valid law."

It is difficult to see any error in this decision, although three Justices dissented. There can be no questioning the fact that the rate sought to be regulated was an interstate rate. Obviously, if such transportation is not to be treated in its entirety, but as divisible by each state, then there would be not only utter confusion in rate-making, but the power of Congress over interstate commerce would be absolutely vitiated.

Pursuing our chronological consideration of cases, we find that by this time it had become a rather common practice for the states to create commissions, as agencies of state supervision and regulation, with rate-making power. It is not necessary to analyze the numerous cases that defined this power. It is sufficient to name the more prominent ones in which the principles again established by the Wabash Case were reaffirmed: *Dow* v. *Beidelman*, *Reagan* v. *Farmers' Loan & Trust Co.*, and *Reagan* v. *Mercantile Trust Company*. . . .

V. The Period of Judicial Amendment

This new period, which we have called the period of Judicial Amendment, began with a reconstructed court in 1913, with the Minnesota Rate Cases. The facts in these cases are briefly as follows: The state line of Minnesota on the east and west runs between cities which are in close proximity, that is, there are various twin cities, such as Superior, Wisconsin, and Duluth, Minnesota; Grand Forks, North Dakota, and East Grand Forks, Minnesota, which, on account of their situations, had always been accorded by the railroad companies serving them like rates in and out. In 1905 and 1906 the State Railroad and Warehouse

Commission of Minnesota, pursuant to acts of the state legislature, ordered reduced the class rates on general merchandise twenty and twenty-five per cent, and corresponding reductions were made in commodity and passenger rates. Simultaneously with this compulsory reduction of intrastate rates, the railroads involved, namely, the Northern Pacific Railway Company, the Great Northern Railway Company, and the Minneapolis and St. Louis Railroad Company, in order to prevent discrimination against localities and the consequent loss of business, reduced to a parity their interstate rates to the corresponding twin cities in each group lying outside the State of Minnesota. Whereupon the stockholders of these roads brought suit to restrain the enforcement of these acts of the legislature and orders of the Commission. The stockholders' contentions were: First, that the newly established rates amounted to an unconstitutional interference with interstate commerce; second, that they were confiscatory; and third, that the penalties imposed for their violation were so severe as to result in a denial of the equal protection of the laws and a deprivation of property without due process of law in violation of the Fourteenth Amendment. The lower court sustained the latter contention, which was affirmed by the United States Supreme Court on appeal, the penal and criminal provisions only of the statutes being considered. The lower court then referred the suits to a special master, who took the evidence and made an elaborate report sustaining the complainants' other contentions. The master's findings were confirmed by the United States Circuit Court for the District of Minnesota (Judge Sanborn) and decrees were entered accordingly. From these decrees the Attorney-General of the state and the members of the State Commission appealed to the Supreme Court. Appreciating the gravity of the controversy, the railroad commissioners of eight states filed their brief as *amici curiae*, as did also the governors of three states, pursuant to a resolution of a conference of the governors of all the states.

The question of the validity of state acts and orders fixing maximum rates was thus presented in two distinct aspects: (1) with respect to their effect on interstate commerce, and (2) as to their alleged confiscatory character. With this second aspect we are not here concerned, and for the purposes of our inquiry the rates fixed by the state will be assumed to be reasonable so far as intrastate traffic is concerned (as they were in fact for the most part found to be by the Supreme Court), that is, rates which the state

in the exercise of its legislative judgment could constitutionally fix for intrastate transportation separately considered. With respect to the branch of the cases with which we are here concerned, namely, the effect of these rates upon interstate commerce, the decree of the lower court which was under review was shown to rest upon two distinct grounds: First, that the action of the state imposed a direct burden upon interstate commerce; and second, that it was in conflict with the provisions of the act to regulate commerce.

As to the first proposition, namely, that the action of the State of Minnesota in prescribing new and lower intrastate rates thereby imposed a direct burden upon interstate commerce, the conclusion of the Supreme Court that it did not must be accepted as sound. But the qualification placed by the court, without a dissenting vote to be sure, upon the state's authority over intrastate rates is believed to contain an enunciation of congressional power which was not only unnecessary for the decision in these cases, but which has no support in former decisions, and which, furthermore, if acted upon in future instances, may give rise to an alarming conflict between state and federal interests detrimental to the preservation of our dual form of government.

"Was the state," asks Mr. Justice Hughes, "in prescribing a general tariff of reasonable intrastate rates otherwise within its authority, bound not to go below a minimum standard established by the interstate rates made by the carriers within competitive districts? If the state power, independently of federal legislation, is thus limited, the inquiry need proceed no further." The court declares that the state power is not so limited because, as we have seen, Chief Justice Marshall indelibly wrote upon our constitutional jurisprudence in the case of *Gibbons* v. *Ogden*, that the completely internal commerce of a state is reserved for the state itself. But, adds the court:

"This reservation to the states manifestly is only of that authority which is consistent with and not opposed to the grant to Congress. There is no room in our scheme of government for the assertion of state power in hostility to the authorized exercise of federal power. The authority of Congress extends to every part of interstate commerce, and to every instrumentality or agency by which it is carried on; and the full control by Congress of the subjects committed to its regulation is not to be denied or thwarted by the commingling of interstate and intrastate operations. This is not to say that the nation may deal with the internal concerns

of the state, as such, but that the execution by Congress of its constitutional power to regulate interstate commerce is not limited by the fact that intrastate transactions may have become so interwoven therewith that the effective government of the former incidentally controls the latter. This conclusion necessarily results from the supremacy of the national power within its appointed sphere. . . .

"The grant in the Constitution of its own force, that is, without action by Congress, established the essential immunity of interstate commercial intercourse from the direct control of the states with respect to those subjects embraced within the grant which are of such a nature as to demand that, if regulated at all, their regulation should be prescribed by a single authority. It has repeatedly been declared by this court that as to those subjects which require a general system or uniformity of regulation the power of Congress is exclusive. In other matters, admitting of diversity of treatment according to the special requirements of local conditions, the states may act within their respective jurisdictions until Congress sees fit to act; and, when Congress does act, the exercise of its authority overrides all conflicting state legislation. . . .

"The principle, which determines this classification, underlies the doctrine that the states cannot under any guise impose direct burdens upon interstate commerce. For this is but to hold that the states are not permitted directly to regulate or restrain that which from its nature should be under the control of the one authority and be free from restriction save as it is governed in the manner that the national legislature constitutionally ordains."

Considering first those subjects which require a general system or uniformity of regulation and over which therefore the power of Congress is exclusive, the court cites a great number of cases, of which the leading ones have already been referred to in this article, maintaining the freedom of interstate commerce from all modes of direct interference by the states, the most typical example of which being, of course, taxation in its varied forms. . . .

Turning now to a consideration of the further question whether the action of the State of Minnesota was repugnant to any provision of the Interstate Commerce Act, the court in the Minnesota Cases also answered this in the negative, by demonstrating that purely intrastate commerce had always been expressly excepted from the operation of the act by the proviso contained in the first section. "The fixing of reasonable rates for intrastate transportation was left," said the court after giving a history of the act, "where it had been found; that is, with the states and the agencies created by the states to deal with that subject. . . . Thus far the

court's reasoning is clear, succinct and eminently sound. When pressed, however, with the more troublesome argument that the provisions of Section 3 of the act, prohibiting carriers from giving an undue or unreasonable preference or advantage to any locality, applied to an unreasonable discrimination between localities in different states, as well when arising from an intrastate rate as compared with an interstate rate as when due to interstate rates exclusively, the court reserved its opinion, in accordance with its prior rulings, because the Interstate Commerce Commission had made no finding in regard to the Minnesota rates, and no action of that body was before the court for review. However, as we shall see, this question was not to be reserved for long.

The court again proceeded with an analysis of cases which we have earlier considered, in order to confirm the principle that after the passage of the Interstate Commerce Act, just as before, the state continued to possess that state-wide authority which it formerly enjoyed to prescribe reasonable rates for its exclusively internal traffic.

In concluding, the court reverted to its theory, expressed earlier in the opinion, of a dominant federal and a servient state power, and virtually said that the Interstate Commerce Act might be amended without amending the Constitution so as to include specifically the regulation of intrastate rates.

"If the situation has become such," said the court, "by reason of the interblending of the interstate and intrastate operations of interstate carriers, that adequate regulation of their interstate rates cannot be maintained without imposing requirements with respect to their intrastate rates which substantially affect the former, it is for Congress to determine, within the limits of its constitutional authority over interstate commerce and its instruments the measure of the regulation it should apply. It is the function of this court to interpret and apply the law already enacted, but not under the guise of construction to provide a more comprehensive scheme of regulation than Congress has decided upon. Nor, in the absence of federal action, may we deny effect to the laws of the state enacted within the field which it is entitled to occupy until its authority is limited through the exertion by Congress of its paramount constitutional power."

Of what real value could it be to declare that, in so far as the reasonableness *per se* of local rates is concerned, the present Interstate Commerce Act necessarily forbids, by express proviso, any

interference by the federal government, when at the same moment it is declared with greater emphasis that this power of the states over their local rates is supreme *only until Congress acts?* This indeed pointed the way to destruction of state power. And the way was not a difficult one. In fact it proved to be shorter than it seemed from the court's language. The Interstate Commerce Commission, ever zealous for greater authority, anticipated the opinion of the Supreme Court on the question that was reserved in the Minnesota opinion, and within a year from the rendering of that opinion has, it is believed, in the Shreveport Cases virtually accomplished without any additional legislation whatsoever all that that opinion pointed out might be done only by additional legislation. State regulation of intrastate rates seemed doomed by the Minnesota Cases, but certainly its death was not expected to come so soon. Let us see what are the facts in the Shreveport Cases and exactly what the court decided.

In 1911 the Railroad Commission of Louisiana filed a petition with the Interstate Commerce Commission against the Texas & Pacific Railway Company, the Houston East and West Texas Railway Company, and various other carriers, the basis of the complaint being that the carriers made rates out of Dallas and other Texas points into eastern Texas, which were much lower than those which they extended into Texas from Shreveport, Louisiana. Shreveport is about forty miles from the Texas state line, and two hundred and thirty-one miles from Houston, Texas. It is one hundred and eighty-nine miles from Dallas. It competes with both Houston and Dallas for the trade of the intervening territory. The rates from Dallas and Houston, respectively, eastward to intermediate points in Texas, were much less, according to distance, than from Shreveport westward to the same points. It was undisputed that the difference was substantial and injuriously affected the commerce of Shreveport. Such was the frank purpose of the Texas commission. For example, the rate on furniture from Dallas to Longview, Texas, 124 miles, was 24.8 cents per hundred pounds, while the rate from Shreveport to Longview, 65.7 miles, was 35 cents.

The order of the Interstate Commerce Commission had two phases. First, it established maximum class rates out of Shreveport to certain-named Texas points, which were substantially the same as the class rates which had been fixed by the Texas Commission and charged by the carriers for transportation for similar

distances within the State of Texas. Second, the Commission held that maintaining lower commodity rates (which are specially reduced class rates) from Dallas and Houston to points in Texas than were in force from Shreveport to such points, under substantially similar conditions and circumstances, created an unjust discrimination against Shreveport in favor of the Texas points. The carriers complied with the first part of the order and established the class rates, but still left in effect their low intrastate commodity rates which the Commission declared caused the above discrimination. The point of objection to complying with the second part of the order was that, since the discrimination found by the Commission to be undue arose out of a relation of intrastate rates, maintained under state authority, to interstate rates that had been upheld as reasonable, its correction was beyond the Commission's power. On appeal to the Commerce Court, that court held that the Commission's order relieved the railroads from all further obligation to observe the intrastate rates, and that they were at liberty to comply with the Commission's requirements by increasing these rates sufficiently to remove the forbidden discrimination. Thus, when the case reached the Supreme Court, the invalidity of the order of the Commission was challenged upon two grounds: First, that Congress is impotent to control the intrastate charges of an interstate carrier, even to the extent necessary to prevent injurious discrimination against interstate traffic. Second, that if it be assumed that Congress has this power, still it has not been exercised, and hence the action of the Commission exceeded the limits of the authority which has been conferred upon it.

Both of these grounds were declared untenable, and the court affirmed in full the orders of the Commission and the Commerce Court. As to the first ground, the result was to be anticipated, because virtually decided in the Minnesota Cases, as we have just seen. But not so as to the second ground. Indeed, three of the seven Interstate Commerce Commissioners had denied that the act gave them such power, desirable as it was. Justices Lurton and Pitney also dissented, but without expressing any reasons, which is to be regretted in such an important case.

The decision is meagre and unconvincing, as an example of statutory construction, and as such it must be primarily considered because the first consideration, that is, whether the order of the Commission was invalid on the ground that it exceeded the authority which Congress could lawfully confer, was disposed of by

the Minnesota Cases, and the opinion of the court adds nothing to what had already been said. There is apparently the same disposition to confuse the action of Congress, through the Commission, with prior congressional action which operated directly upon the instrumentalities, or the very subject-matter of interstate commerce itself. Intrastate rates are never the instrumentalities or subject-matter of interstate commerce. Unless they represent that completely internal commerce of a state which since the time of *Gibbons* v. *Ogden* had been thought to be securely reserved to the states themselves, when can there ever be such commerce? Note the language of the court after analyzing the undisputed authority of the various cases dealing with the paramount power of Congress over safety appliances, hours of labor, employers' liability and the like:

"While these decisions sustaining the federal power relate to measures adopted in the interest of the safety of persons and property, they illustrate the principle that Congress in the exercise of its paramount power may prevent the common instrumentalities of interstate and intrastate commercial intercourse from being used in their intrastate operations to the injury of interstate commerce. This is not to say that Congress possesses the authority to regulate the internal commerce of a state, as such, but that it does possess the power to foster and protect interstate commerce, and to take all measures necessary or appropriate to that end, although intrastate transactions of interstate carriers may thereby be controlled."

Well-sounding phrases these, but totally illogical. Since, as the Supreme Court has many times said in determining whether state legislation has unduly burdened interstate commerce, it must look through form to substance—must consider the real effect of the state legislation—why should it not do the same when the situation is reversed? For each power is equally plenary within its given sphere. Why did not the Supreme Court in both the Minnesota and Shreveport Cases face the situation squarely and admit that amendment of the Constitution, difficult as it is of attainment—and rightly so—is the only true remedy? "The power to deal with the relation between the two kinds of rates, as a relation, lies exclusively with Congress," reiterates the court. Yet in order to prove this the court relies upon a case, *Louisville & Nashville R. R. Co.* v. *Eubank*, . . . wherein it was expressly held that if Congress had regulated the interstate rate there involved "there would be in that case no interference with or regula-

tion of interstate commerce directly or indirectly by the state, its action could have no possible effect upon the interstate rate, as the amount of the charge would be regulated by the body with which the right of regulation exists."

To use the words of Justice Brewer, dissenting in the Eubank Case, "it is strange to be told that the action of a carrier in fixing interstate rates is potent to render unconstitutional the legislation of the state respecting local rates, when the like action of Congress in prescribing interstate rates is not so potent. In other words, action by the carrier in pursuit of its own financial interests overturns the constitution and statute of the state when like action by Congress in the exercise of its constitutional power does not." Does not the reasoning of Justice Hughes in the Shreveport Cases more nearly support the minority rather than the majority opinion in the Eubank Case?

Turning now to the second and really the vital question in the Shreveport Cases, namely, whether the Interstate Commerce Commission exceeded the authority given to it under the Interstate Commerce Act, the court, with a mere wave of its hand, sweeps aside the controlling proviso in Section 1 of the act, expressly excluding intrastate commerce from its jurisdiction. The whole history of the debates over the passage of the act, which the court cautiously avoids, would seem to show that it would never have been passed had it been believed to be capable of the construction which the Supreme Court has now placed upon it. Clearly, this is judicial legislation. How could the court so soon erase what it had said in the Minnesota Cases,—that it is not its function "under the guise of construction to provide a more comprehensive scheme of regulation than Congress has decided upon"?

With equal ease the court overrules the case of *East Tennessee, etc. Ry. Co.* v. *Interstate Commerce Commission* in order to accomplish its purpose, though of course without admitting that it does. Thirteen years before, it had decided in that case that the prohibition of Section 3 of the act was directed only against unjust discrimination and undue preference arising from the voluntary and wrongful act of the carriers, and did not relate to acts the result of conditions wholly beyond the control of the carriers, such as competition, and presumably therefore statute, court decree or order of an administrative, or semi-judicial body. "In the view that the Commission was entitled to make the order, there is no longer compulsion upon the carriers by virtue of any inconsistent

local requirement," now says the court, and thus the case of *East Tennessee, etc. Ry. Co.* v. *Interstate Commerce Commission* is summarily disposed of by assuming as a premise the very question to be proved. "We are not unmindful," says the court, concluding its opinion, "of the gravity of the question that is presented when state and federal views conflict. But it was recognized at the beginning that the nation could not prosper if interstate and foreign trade were governed by many masters, and where the interests of the freedom of interstate commerce are involved, the judgment of Congress and of the agencies it lawfully establishes must control."

Thus Mr. Justice Hughes would carry us back again over those ninety years of decisions that we have just reviewed—back to *Gibbons* v. *Ogden*—and have us understand, from the lips of Chief Justice Marshall, that if Congress so wills it there shall be no internal commerce of a state. For such is necessarily to be the result of the Minnesota and Shreveport decisions. In the former the court said that "the situation is not peculiar to Minnesota. The same question has been presented by the appeals, now before the court, which involve the validity of intrastate tariffs fixed by Missouri, Arkansas, Kentucky and Oregon. Differences in particular facts appear, but they cannot be regarded as controlling." These appeals were all decided in conformity with the opinion in the Minnesota Cases. As for the Shreveport decision, it is almost a truism to say that nearly every rate controversy to-day presents a question of discrimination as well as of unreasonableness *per se*. Months before the Shreveport decision was rendered, shippers in states adjoining Minnesota, believing that the court would decide as it has done, filed dozens of complaints based on discriminations which they alleged had resulted from the application of the scale of rates approved in the Minnesota Cases. Before the Shreveport decision the Interstate Commerce Commission had no further power after it had fixed the interstate rate at a reasonable maximum. Its hands were tied. Now it has an option of either changing the interstate rate or changing the local rate. Nor is there any persuasive force in the argument that in most instances the Interstate Commerce Commission will proceed with caution, feeling discretion to be the better part of valor, and will elect to exert its influence upon the interstate rate whenever possible. The point is, the *power* to do otherwise is still there.

We have seen how Chief Justice Marshall first gave expression

to the exclusive power of Congress in relation to matters purely national, and to the equally exclusive power of the states in relation to matters purely internal. We have seen how as a necessary corollary to these principles he first announced a third principle of concurrent powers, or, as we believe we have more appropriately described them, a dominant federal and a servient state power in matters which, although local in their nature, yet affect interstate commerce. We have seen our highest judiciary vacillating in its acceptance of this third and more novel principle until it was finally established in our constitutional law, as firmly as had been established the two earlier principles. But never, in any of the decisions, have we found support for this new fourth theory which the Minnesota and Shreveport Cases have evolved—the theory of a dominant federal and a servient state power in a field hitherto unconditionally reserved to the states—the field of local rate-making. Further, it is all the more strange to be told that the legislative branch of the government, Congress, through its administrative agent, the Interstate Commerce Commission, and not the judiciary shall determine what is a forbidden interference with interstate commerce. Such is the decision in the Shreveport Cases, for a ruling must first be obtained from the Commission before recourse may be had to the courts, and furthermore, under the provisions of the Interstate Commerce Act, it would seem that the railroads cannot, themselves, institute the necessary proceedings—an undue hardship unquestionably on the railroads. But why need resort first be had to the Commission? Its function is to determine questions of fact,—whether a given rate is reasonable *per se* or discriminatory in relation to other interstate rates. In an action for damages, therefore, the propriety of the established requirement that a ruling of the Commission be first had, cannot be disputed. But in the Shreveport Cases the question is primarily one of constitutional law, namely, whether what a state has done is a violation of the commerce clause. This is the same question involved in every case that we have considered. In the Eubank Case, upon which the court so much relies, no resort to the Commission was required. Wherein is the difference? The Supreme Court, *ab inconvenienti*, has read out of the Interstate Commerce Act the very passage that rendered it constitutional. After this, to what may not the alluring arguments of expediency lead us?

CHAPTER XXXI

THE SUPREMACY OF THE FEDERAL GOVERNMENT [1]

1. Shreveport Rate Cases [2]

Mr. Justice Hughes delivered the opinion of the court.

These suits were brought in the Commerce Court by the Houston, East & West Texas Railway Company, and the Houston & Shreveport Railroad Company, and by the Texas & Pacific Railway Company, respectively, to set aside an order of the Interstate Commerce Commission, dated March 11, 1912, upon the ground that it exceeded the Commission's authority. Other railroad companies intervened in support of the petitions, and the Interstate Commerce Commission and the Railroad Commission of Louisiana intervened in opposition. The petitions were dismissed. 205 Fed. Rep. 380.

The order of the Interstate Commerce Commission was made in a proceeding initiated in March, 1911, by the Railroad Commission of Louisiana. The complaint was that the appellants, and other interstate carriers, maintained unreasonable rates from Shreveport, Louisiana, to various points in Texas, and, further, that these carriers in the adjustment of rates over their respective lines unjustly discriminated in favor of traffic within the State of Texas and against similar traffic between Louisiana and Texas. The carriers filed answers; numerous pleas of intervention by shippers and commercial bodies were allowed; testimony was taken and arguments were heard.

The gravamen of the complaint, said the Interstate Commerce Commission, was that the carriers made rates out of Dallas and other Texas points into eastern Texas which were much lower than those which they extended into Texas from Shreveport. The situation may be briefly described: Shreveport, Louisiana, is about 40 miles from the Texas state line, and 231 miles from Hous-

[1] See Vanderblue and Burgess, pp. 13, 17–27, 47–51, 225–229, 234–236, and Jones, pp. 199–209, 322–324, 346, 380–381, 553–555, 557, 569–570.

[2] *Houston, East and West Texas Railway Company* v. *United States*, 234 U. S. 342 (June 8, 1914). See Vanderblue and Burgess, pp. 17, 128, 357, and Jones, pp. 205–208.

ton, Texas, on the line of the Houston, East & West Texas and Houston & Shreveport Companies (which are affiliated in interest); it is 189 miles from Dallas, Texas, on the line of the Texas & Pacific.[1] Shreveport competes with both cities for the trade of the intervening territory. The rates on these lines from Dallas and Houston, respectively, eastward to intermediate points in Texas were much less, according to distance, than from Shreveport westward to the same points. It is undisputed that the difference was substantial and injuriously affected the commerce of Shreveport. It appeared, for example, that a rate of 60 cents carried first class

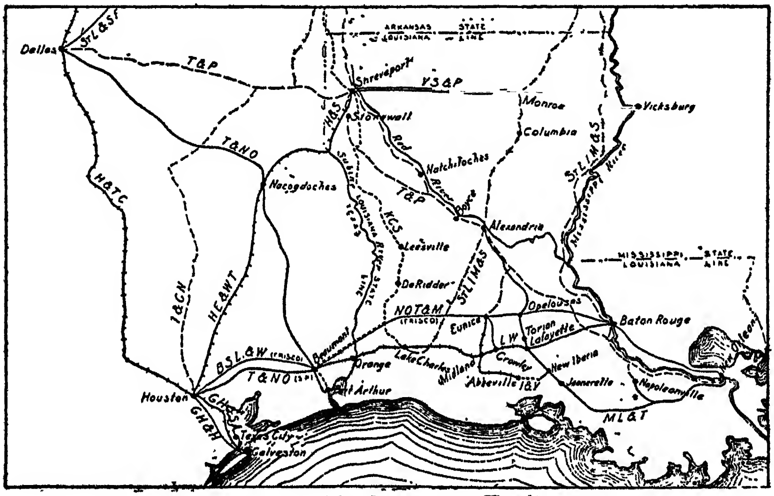


PLATE 24.—The Shreveport Territory.

traffic a distance of 160 miles to the eastward from Dallas, while the same rate would carry the same class of traffic only 55 miles into Texas from Shreveport. The first class rate from Houston to Lufkin, Texas, 118.2 miles, was 50 cents per 100 pounds, while the rate from Shreveport to the same point, 112.5 miles, was 69 cents. The rate on wagons from Dallas to Marshall, Texas, 147.7 miles, was 36.8 cents, and from Shreveport to Marshall, 42 miles, 56 cents. The rate on furniture from Dallas to Longview, Texas, 124 miles, was 24.8 cents, and that from Shreveport to Longview, 65.7 miles, was 35 cents. These instances of differences in rates are merely illustrative; they serve to indicate the character of the rate adjustment.

The Interstate Commerce Commission found that the inter-

[1] See Plate 24, which is taken from 32 I. C. C. 249.—Ed.

state class rates out of Shreveport to named Texas points were unreasonable, and it established maximum class rates for this traffic. These rates, we understand, were substantially the same as the class rates fixed by the Railroad Commission of Texas, and charged by the carriers, for transportation for similar distances in that State. The Interstate Commerce Commission also found that the carriers maintained "higher rates from Shreveport to points in Texas" than were in force "from cities in Texas to such points under substantially similar conditions and circumstances," and that thereby "an unlawful and undue preference and advantage" was given to the Texas cities and a "discrimination" that was "undue and unlawful" was effected against Shreveport. In order to correct this discrimination, the carriers were directed to desist from charging higher rates for the transportation of any commodity from Shreveport to Dallas and Houston, respectively, and intermediate points, than were contemporaneously charged for the carriage of such commodity from Dallas and Houston toward Shreveport for equal distances, as the Commission found that relation of rates to be reasonable. 23 I. C. C. 31, 46-48.

. . . The report states that . . . it will be the duty of the companies "to duly and justly equalize the terms and conditions" upon which they will extend "transportation to traffic of a similar character moving into Texas from Shreveport with that moving wholly within Texas," but that, in effecting such equalization, the class scale rates as prescribed shall not be exceeded.

In their petition in the Commerce Court, the appellants assailed the order in its entirety, but subsequently they withdrew their opposition to the fixing of maximum class rates and these rates were put in force by the carriers in May, 1912.

The attack was continued upon that portion of the order which prohibited the charge of higher rates for carrying articles from Shreveport into Texas than those charged for eastward traffic from Dallas and Houston, respectively, for equal distances. There are, it appears, commodity rates fixed by the Railroad Commission of Texas for intrastate hauls, which are substantially less than the class, or standard, rates prescribed by that Commission; and thus the commodity rates charged by the carriers from Dallas and Houston eastward to Texas points are less than the rates which they demand for the transportation of the same articles for like distances from Shreveport into Texas. The present controversy relates to these commodity rates.

The point of the objection to the order is that, as the discrimination found by the Commission to be unjust arises out of the relation of intrastate rates, maintained under state authority, to interstate rates that have been upheld as reasonable, its correction was beyond the Commission's power. Manifestly the order might be complied with, and the discrimination avoided, either by reducing the interstate rates from Shreveport to the level of the competing intrastate rates, or by raising these intrastate rates to the level of the interstate rates, or by such reduction in the one case and increase in the other as would result in equality. But it is urged that, so far as the interstate rates were sustained by the Commission as reasonable, the Commission was without authority to compel their reduction in order to equalize them with the lower intrastate rates. The holding of the Commerce Court was that the order relieved the appellants from further obligation to observe the intrastate rates and that they were at liberty to comply with the Commission's requirements by increasing these rates sufficiently to remove the forbidden discrimination. The validity of the order in this aspect is challenged upon two grounds:

(1) That Congress is impotent to control the intrastate charges of an interstate carrier even to the extent necessary to prevent injurious discrimination against interstate traffic; and

(2) That, if it be assumed that Congress has this power, still it has not been exercised, and hence the action of the Commission exceeded the limits of the authority which has been conferred upon it.

First. It is unnecessary to repeat what has frequently been said by this court with respect to the complete and paramount character of the power confided to Congress to regulate commerce among the several States. It is of the essence of this power that, where it exists, it dominates. Interstate trade was not left to be destroyed or impeded by the rivalries of local governments. The purpose was to make impossible the recurrence of the evils which had overwhelmed the Confederation and to provide the necessary basis of national unity by insuring 'uniformity of regulation against conflicting and discriminating state legislation.' By virtue of the comprehensive terms of the grant, the authority of Congress is at all times adequate to meet the varying exigencies that arise and to protect the national interest by securing the freedom of interstate commercial intercourse from local control. . . .

Congress is empowered to regulate,—that is, to provide the law

for the government of interstate commerce; to enact 'all appropriate legislation' for its 'protection and advancement' . . . ; to adopt measures 'to promote its growth and insure its safety' . . . ; 'to foster, protect, control and restrain.' . . . Its authority, extending to these interstate carriers as instruments of interstate commerce, necessarily embraces the right to control their operation in all matters having such a close and substantial relation to interstate traffic that the control is essential or appropriate to the security of that traffic, to the efficiency of the interstate service, and to the maintenance of conditions under which interstate commerce may be conducted upon fair terms and without molestation or hindrance. As it is competent for Congress to legislate to these ends, unquestionably it may seek their attainment by requiring that the agencies of interstate commerce shall not be used in such manner as to cripple, retard or destroy it. The fact that carriers are instruments of intrastate commerce, as well as of interstate commerce, does not derogate from the complete and paramount authority of Congress over the latter or preclude the Federal power from being exerted to prevent the intrastate operations of such carriers from being made a means of injury to that which has been confided to Federal care. Wherever the interstate and intrastate transactions of carriers are so related that the government of the one involves the control of the other, it is Congress, and not the State, that is entitled to prescribe the final and dominant rule, for otherwise Congress would be denied the exercise of its constitutional authority and the State, and not the Nation, would be supreme within the national field. . . .

In *Baltimore & Ohio Railroad Co.* v. *Interstate Commerce Commission, supra,* the argument against the validity of the Hours of Service Act (March 4, 1907, c. 2939, 34 Stat. 1415) involved the consideration that the interstate and intrastate transactions of the carriers were so interwoven that it was utterly impracticable for them to divide their employés so that those who were engaged in interstate commerce should be confined to that commerce exclusively. Employés dealing with the movement of trains were employed in both sorts of commerce; but the court held that this fact did not preclude the exercise of Federal power. As Congress could limit the hours of labor of those engaged in interstate transportation, it necessarily followed that its will could not be frustrated by prolonging the period of service through other requirements of the carriers or by the commingling of duties relating

to interstate and intrastate operations.[1] Again, in *Southern Railway Co.* v. *United States*, *supra*, the question was presented whether the amendment to the Safety Appliance Act (March 2, 1903, c. 976, 32 Stat. 943) was within the power of Congress in view of the fact that the statute was not confined to vehicles that were used in interstate traffic but also embraced those used in intrastate traffic. The court answered affirmatively, because there was such a close relation between the two classes of traffic moving over the same railroad as to make it certain that the safety of the interstate traffic, and of those employed in its movement, would be promoted in a real and substantial sense by applying the requirements of the act to both classes of vehicles. So, in the *Second Employers' Liability Cases*, *supra*, it was insisted that while Congress had the authority to regulate the liability of a carrier for injuries sustained by one employé through the negligence of another, where all were engaged in interstate commerce, that power did not embrace instances where the negligent employé was engaged in intrastate commerce. The court said that this was a mistaken theory, as the causal negligence when operating injuriously upon an employé engaged in interstate commerce had the same effect with respect to that commerce as if the negligent employé were also engaged therein. The decision in *Employers' Liability Cases*, 207 U. S. 463, is not opposed, for the statute there in question (June 11, 1906, c. 3073, 34 Stat. 232) sought to regulate the liability of interstate carriers for injuries to any employé even though his employment had no connection whatever with interstate commerce. . . .

While these decisions sustaining the Federal power relate to measures adopted in the interest of the safety of persons and property, they illustrate the principle that Congress in the exercise of its paramount power may prevent the common instrumentalities of interstate and intrastate commercial intercourse from being used in their intrastate operations to the injury of interstate commerce. This is not to say that Congress possesses the authority to regulate the internal commerce of a State, as such, but that it does possess the power to foster and protect interstate commerce, and to take all measures necessary or appropriate to that end, although intrastate transactions of interstate carriers may thereby be controlled.

This principle is applicable here. We find no reason to doubt

[1] Cf. p. 292.—Ed.

that Congress is entitled to keep the highways of interstate communication open to interstate traffic upon fair and equal terms. That an unjust discrimination in the rates of a common carrier, by which one person or locality is unduly favored as against another under substantially similar conditions of traffic, constitutes an evil is undeniable; and where this evil consists in the action of an interstate carrier in unreasonably discriminating against interstate traffic over its line, the authority of Congress to prevent it is equally clear. It is immaterial, so far as the protecting power of Congress is concerned, that the discrimination arise from intrastate rates as compared with interstate rates. The use of the instrument of interstate commerce in a discriminatory manner so as to inflict injury upon that commerce, or some part thereof, furnishes abundant ground for Federal intervention. Nor can the attempted exercise of state authority alter the matter, where Congress has acted, for a State may not authorize the carrier to do that which Congress is entitled to forbid and has forbidden.

It is also to be noted—as the Government has well said in its argument in support of the Commission's order—that the power to deal with the relation between the two kinds of rates, as a relation, lies exclusively with Congress. It is manifest that the State cannot fix the relation of the carrier's interstate and intrastate charges without directly interfering with the former, unless it simply follows the standard set by Federal authority. This question was presented with respect to the long and short haul provision of the Kentucky constitution, adopted in 1891, which the court had before it in *Louisville & Nashville R. R. Co.* v. *Eubank*, 184 U. S. 27. The state court had construed this provision as embracing a long haul, from a place outside to one within the State, and a shorter haul on the same line and in the same direction between points within the State. This court held that, so construed, the provision was invalid as being a regulation of interstate commerce because 'it linked the interstate rate to the rate for the shorter haul and thus the interstate charge was directly controlled by the state law.' See 230 U. S. pp. 428, 429. It is for Congress to supply the needed correction where the relation between intrastate and interstate rates presents the evil to be corrected, and this it may do completely by reason of its control over the interstate carrier in all matters having such a close and substantial relation to interstate commerce that it is

necessary or appropriate to exercise the control for the effective government of that commerce.

It is also clear that, in removing the injurious discriminations against interstate traffic arising from the relation of intrastate to interstate rates, Congress is not bound to reduce the latter below what it may deem to be a proper standard fair to the carrier and to the public. Otherwise, it could prevent the injury to interstate commerce only by the sacrifice of its judgment as to interstate rates. Congress is entitled to maintain its own standard as to these rates and to forbid any discriminatory action by interstate carriers which will obstruct the freedom of movement of interstate traffic over their lines in accordance with the terms it establishes.

Having this power, Congress could provide for its execution through the aid of a subordinate body; and we conclude that the order of the Commission now in question cannot be held invalid upon the ground that it exceeded the authority which Congress could lawfully confer.

Second. The remaining question is with regard to the scope of the power which Congress has granted to the Commission.

Section three of the Act to Regulate Commerce provides (February 4, 1887, c. 104, 24 Stat. 379, 380):

"SEC. 3. That it shall be unlawful for any common carrier subject to the provisions of this act to make or give any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, or locality, or any particular description of traffic, in any respect whatsoever, or to subject any particular person, company, firm, corporation, or locality, or any particular description of traffic, to any undue or unreasonable prejudice or disadvantage in any respect whatsoever."

This language is certainly sweeping enough to embrace all the discriminations of the sort described which it was within the power of Congress to condemn. There is no exception or qualification with respect to an unreasonable discrimination against interstate traffic produced by the relation of intrastate to interstate rates as maintained by the carrier. It is apparent from the legislative history of the act that the evil of discrimination was the principal thing aimed at, and there is no basis for the contention that Congress intended to exempt any discriminatory action or practice of interstate carriers affecting interstate commerce which it had authority to reach. The purpose of the meas-

ure was thus emphatically stated in the elaborate report of the Senate Committee on Interstate Commerce which accompanied it: "The provisions of the bill are based upon the theory that the paramount evil chargeable against the operation of the transportation system of the United States as now conducted is unjust discrimination between persons, places, commodities, or particular descriptions of traffic. The underlying purpose and aim of the measure is the prevention of these discriminations. . . . " (Senate Report No. 46, 49th Cong., 1st Sess., p. 215.)

The opposing argument rests upon the proviso in the first section of the act which in its original form was as follows: "*Provided, however,* that the provisions of this act shall not apply to the transportation of passengers or property, or to the receiving, delivering, storage, or handling of property, wholly within one State, and not shipped to or from a foreign country from or to any State or Territory as aforesaid." When the act was amended so as to confer upon the Commission the authority to prescribe maximum interstate rates, this proviso was reënacted; and when the act was extended to include telegraph, telephone, and cable companies engaged in interstate business, an additional clause was inserted so as to exclude intrastate messages. . . .

Congress thus defined the scope of its regulation and provided that it was not to extend to purely intrastate traffic. It did not undertake to authorize the Commission to prescribe intrastate rates and thus to establish a unified control by the exercise of the rate-making power over both descriptions of traffic. Undoubtedly—in the absence of a finding by the Commission of unjust discrimination—intrastate rates were left to be fixed by the carrier and subject to the authority of the States or of the agencies created by the States. This was the question recently decided by this court in the *Minnesota Rate Cases, supra.* There, the State of Minnesota had established reasonable rates for intrastate transportation throughout the State and it was contended that, by reason of the passage of the Act to Regulate Commerce, the State could no longer exercise the state-wide authority for this purpose which it had formerly enjoyed; and the court was asked to hold that an entire scheme of intrastate rates, otherwise validly established, was null and void because of its effect upon interstate rates. There had been no finding by the Interstate Commerce Commission of any unjust discrimination. The present question, however, was reserved, the court saying (230 U. S. p. 419): "It is

urged, however, that the words of the proviso" (referring to the proviso above-mentioned) "are susceptible of a construction which would permit the provisions of section three of the act, prohibiting carriers from giving an undue or unreasonable preference or advantage to any locality, to apply to unreasonable discriminations between localities in different States, as well when arising from an intrastate rate as compared with an interstate rate as when due to interstate rates exclusively. If it be assumed that the statute should be so construed, and it is not necessary now to decide the point, it would inevitably follow that the controlling principle governing the enforcement of the act should be applied to such cases as might thereby be brought within its purview; and the question whether the carrier, in such a case, was giving an undue or unreasonable preference or advantage to one locality as against another, or subjecting any locality to an undue or unreasonable prejudice or disadvantage, would be primarily for the investigation and determination of the Interstate Commerce Commission and not for the courts."

Here, the Commission expressly found that unjust discrimination existed under substantially similar conditions of transportation and the inquiry is whether the Commission had power to correct it. We are of the opinion that the limitation of the proviso in section one does not apply to a case of this sort. The Commission was dealing with the relation of rates injuriously affecting, through an unreasonable discrimination, traffic that was interstate. The question was thus not simply one of transportation that was 'wholly within one State.' These words of the proviso have appropriate reference to exclusively intrastate traffic, separately considered; to the regulation of domestic commerce, as such. The powers conferred by the act are not thereby limited where interstate commerce itself is involved. This is plainly the case when the Commission finds that unjust discrimination against interstate trade arises from the relation of intrastate to interstate rates as maintained by a carrier subject to the act. Such a matter is one with which Congress alone is competent to deal, and, in view of the aim of the act and the comprehensive terms of the provisions against unjust discrimination, there is no ground for holding that the authority of Congress was unexercised and that the subject was thus left without governmental regulation. It is urged that the practical construction of the statute has been the other way. But, in assailing the order, the appellants ask

us to override the construction which has been given to the statute by the authority charged with its execution, and it cannot be said that the earlier action of the Commission was of such a controlling character as to preclude it from giving effect to the law. The Commission, having before it a plain case of unreasonable discrimination on the part of interstate carriers against interstate trade, carefully examined the question of its authority and decided that it had the power to make this remedial order. The Commerce Court sustained the authority of the Commission and it is clear that we should not reverse the decree unless the law has been misapplied. This we cannot say: on the contrary, we are convinced that the authority of the Commission was adequate.

The further objection is made that the prohibition of section three is directed against unjust discrimination or undue preference only when it arises from the voluntary act of the carrier and does not relate to acts which are the result of conditions wholly beyond its control. . . . The reference is not to any inherent lack of control arising out of traffic conditions, but to the requirements of the local authorities which are assumed to be binding upon the carriers. The contention is thus merely a repetition in another form of the argument that the Commission exceeded its power; for it would not be contended that local rules could nullify the lawful exercise of Federal authority. In the view that the Commission was entitled to make the order, there is no longer compulsion upon the carriers by virtue of any inconsistent local requirement. We are not unmindful of the gravity of the question that is presented when state and Federal views conflict. But it was recognized at the beginning that the Nation could not prosper if interstate and foreign trade were governed by many masters, and, where the interests of the freedom of interstate commerce are involved, the judgment of Congress and of the agencies it lawfully establishes must control.

In conclusion: Reading the order in the light of the report of the Commission, it does not appear that the Commission attempted to require the carriers to reduce their interstate rates out of Shreveport below what was found to be a reasonable charge for that service. So far as these interstate rates conformed to what was found to be reasonable by the Commission, the carriers are entitled to maintain them, and they are free to comply with the order by so adjusting the other rates, to which the order relates, as to re-

move the forbidden discrimination. But this result they are required to accomplish.

The decree of the Commerce Court is affirmed in each case.

Affirmed.

MR. JUSTICE LURTON and MR. JUSTICE PITNEY dissent.

2. WISCONSIN PASSENGER FARES CASE [1]

The proceeding out of which this case has grown, known as the Wisconsin Passenger Fares, began in an investigation by the Interstate Commerce Commission, under paragraphs 3 and 4 of § 13 of the Interstate Commerce Act as amended by § 416 of the Transportation Act of 1920 (41 Stat. 484), into alleged undue and unreasonable discrimination against interstate commerce arising out of intrastate railroad rates in Wisconsin. The interstate carriers by steam railroad of the State were made respondents, and the Governor and State Railroad Commission were duly notified. The Interstate Commerce Commission made its report and order November 27, 1920. *Wisconsin Passenger Fares,* 59 I. C. C. 391.

The Commission had investigated the interstate rates of carriers in the United States, in a proceeding known as *Ex parte 74, Increased Rates*, 58 I. C. C. 220, for the purpose of complying with § 15a of the Interstate Commerce Act as amended by § 422 of the Transportation Act of 1920 (41 Stat. 488). That section requires that the Commission so adjust rates that the revenues of the carriers shall enable them as a whole or by groups to earn a fixed net income on their railway property. The Commission ordered an increase for the carriers in the group of which the Wisconsin carriers were a part, of thirty-five per cent. in interstate freight rates, and twenty per cent. in interstate passenger fares and excess baggage charges, and a surcharge upon passengers in sleeping cars amounting to fifty per cent. of the charge for space in such cars to accrue to the rail carriers. Thereupon the carriers applied to the Wisconsin Railroad Commission for corresponding increases in intrastate rates. The state commission granted increases in intrastate freight rates of thirty-five per cent., but denied any in intrastate passenger fares and charges on the sole ground that a

[1] *Railroad Commission of Wisconsin* v. *Chicago, Burlington and Quincy Railroad Company*, 257 U. S. 563 (February 27, 1922). See Vanderblue and Burgess, pp. 357-358, and Jones, pp. 569-570.

state statute prescribed a maximum for passengers of 2 cents a mile.

In the *Wisconsin Passenger Fares,* the Interstate Commerce Commission found that all of the respondent carriers of Wisconsin transported both intrastate and interstate passengers on the same train, with the same service and accommodations; that the state passenger paying the lower rate rode on the same train, in the same car, and perhaps in the same seat with the interstate passenger who paid the higher rate; that the circumstances and conditions were substantially similar for interstate as for intrastate passenger service in Wisconsin; that travelers destined to, or coming from, points outside the State found it cheaper to pay the intrastate fare within Wisconsin and the interstate fare beyond the border than to pay the through interstate fare; that undue preference and prejudice were shown by the falling off of sales of tickets from border line points in Minnesota and Michigan to stations in Wisconsin, and by a marked increase in sales of local tickets from corresponding border line points in Wisconsin to stations in Wisconsin; that the evidence as to the practice with respect to passenger fares applied in like manner to the surcharge upon passengers in sleeping and parlor cars and to excess baggage charges.

The Commission further found that the fare necessary to fulfill the requirement as to net income of this interstate railroad group under § 15a was 3.6 cents per mile, and that this was reasonable, that the direct revenue loss to the Wisconsin carriers, due to their failure to secure the 20 per cent. increase in intrastate fares, would approximate $2,400,000 per year if the 3-cent fare fixed by the President under federal war control, were continued, and $6,000,000 per year if the 2-cent fare named in the state statute, should become effective.

The Commission found that there was undue, unreasonable and unjust discrimination against persons traveling in interstate commerce and against interstate commerce as a whole; and ordered that the undue discrimination should be removed by increases in all intrastate passenger fares and excess baggage charges and by surcharges corresponding with the increases and surcharges ordered in interstate business.

The order was made without prejudice to the right of the authorities of the State or of any other party in interest to apply in the proper manner for a modification of the order as to any specified

intrastate fares or charges if the latter were not related to the interstate fares or charges in such a way as to contravene the provisions of the Interstate Commerce Act.

The carriers filed bills in equity, of which the present is one, in the District Court to enjoin the State Railroad Commission and other state officials from interfering with the maintenance of the fares thus ordered and published.

Application for interlocutory injunction was made to the District Court under § 266 of the Judicial Code. After a hearing before three judges, they granted an interlocutory injunction from which this appeal was taken. . . .

Mr. Chief Justice Taft, after stating the case, delivered the opinion of the court.

The Commission's order, interference with which was enjoined by the District Court, effects the removal of the unjust discrimination found to exist against persons in interstate commerce, and against interstate commerce by fixing a minimum for intrastate passenger fares in Wisconsin at 3.6 cents per mile per passenger. This is done under paragraph 4 of § 13 of the Interstate Commerce Act, as amended by the Transportation Act of 1920, which authorizes the Interstate Commerce Commission, after a prescribed investigation, to remove

"Any undue or unreasonable advantage, preference or prejudice as between persons or localities in intrastate commerce, on the one hand, and interstate or foreign commerce, on the other hand, or any undue, unreasonable or unjust discrimination against interstate commerce."

We have two questions to decide.

First. Do the intrastate passenger fares work undue prejudice against persons in interstate commerce, such as to justify a horizontal increase of them all?

Second. Are these intrastate fares an undue discrimination against interstate commerce as a whole which it is the duty of the Commission to remove?

We shall consider these in their order.

First. The report and findings of the Commission undoubtedly show that the intrastate fares work an undue discrimination against travelers in interstate commerce and against localities (*Houston, East & West Texas Ry.* v. *United States*, 234 U. S. 342) in typical instances numerous enough to justify a general finding

against a large class of fares. In a general order thus supported, possible injustice can be avoided by a saving clause allowing any one to except himself from the order by proper showing. This practice is fully sustained by precedent in what was done as a sequence of the *Shreveport Case*. . . . In *Illinois Central R. R. Co.* v. *State Public Utilities Commission*, 245 U. S. 493, 508, this court indicated its approval of such practice which was adopted by the Commission. 49 I. C. C. 713. Any rule which would require specific proof of discrimination as to each fare or rate and its effect would completely block the remedial purpose of the statute.

The order in this case, however, is much wider than the orders made in the proceedings following the *Shreveport* and *Illinois Central Cases*. There, as here, the report of the Commission showed discrimination against persons and localities at border points, and the orders were extended to include all rates or fares from all points in the State to border points. But this order is not so restricted. It includes fares between all interior points although neither may be near the border and the fares between them may not work a discrimination against interstate travelers at all. Nothing in the precedents cited justifies an order affecting all rates of a general description when it is clear that this would include many rates not within the proper class or the reason of the order. In such a case, the saving clause by which exceptions are permitted, can not give the order validity. As said by this Court in the *Illinois Central R. R. Case*, "it is obvious that an order of a subordinate agency, such as the Commission, should not be given precedence over a state rate statute, otherwise valid, unless, and except so far as, it conforms to a high standard of certainty." . . .

If, in view of the changes, made by federal authority, in a large class of discriminating state rates, it is necessary from a state point of view to change non-discriminating state rates to harmonize with them, only the state authorities can produce such harmony. We cannot sustain the sweep of the order in this case on the showing of discrimination against persons or places alone.

Second. The report of the Commission shows that if the intrastate passenger fares in Wisconsin are to be limited by the statute of that State to 2 cents per mile, and charges for extra baggage and sleeping car accommodations are to be reduced in a corresponding degree, the net income of the interstate carriers of the State will be cut six millions of dollars below what it would be under intra-

state rates on the same level with interstate rates. Under paragraphs 3 and 4 of § 13 and § 15a as enacted in §§ 416 and 422 respectively of the Transportation Act of 1920, are such reduction and disparity an "undue, unreasonable and unjust discrimination against interstate or foreign commerce" which the Interstate Commerce Commission may remove by raising the intrastate fares? A short reference to the circumstances inducing the legislation and a summary of its relevant provisions will aid the answer to this question.

The Interstate Commerce Act of 1887, 24 St. 379, was enacted by Congress to prevent interstate railroad carriers from charging unreasonable rates and from unjustly discriminating between persons and localities. The railroads availed themselves of the weakness and cumbrous machinery of the original law to defeat its purpose, and this led to various amendments culminating in the amending Act of 1910, 36 Stat. 539, in which the authority of the Commission in dealing with the carriers was made summary and effectively complete. Whatever the causes, the fact was that the carrying capacity of the railroads did not thereafter develop proportionately with the growth of the country, and it became difficult for them to secure additional investment of capital on feasible terms. When the extraordinary demand for transportation arose in 1917, the Congress and the President concluded to take over all the railroads into the management of the Federal Government, and by joint use of facilities, which the Anti-Trust Law was thought to forbid under private management and by use of Government credit, to increase their effectiveness. This was done by appropriate legislation and executive action under the war power. From January 1, 1918, until March 1, 1920, when the Transportation Act went into effect, the common carriers by steam railroad of the country were operated by the Federal Government. Due to the rapid rise in the prices of material and labor in 1918 and 1919, the expense of their operation had enormously increased by the time it was proposed to return the railroads to their owners. The owners insisted that their properties could not be turned back to them by the Government for useful operation without provision to aid them to meet a situation in which they were likely to face a demoralizing lack of credit and income. Congress acquiesced in this view. The Transportation Act of 1920 was the result. It was adopted after elaborate investigations by the Interstate Commerce Committees of the two Houses.

Under Title II it made provision for the termination of federal control March 1, 1920, for the refunding of the carriers' indebtedness to the United States, and for a guaranty for six months to the carriers of an income equal to the war-time rental for their properties, and directed that for two years following the termination of federal control, the Secretary of the Treasury, upon certificate of the Commission might make loans to the carriers not exceeding the maximum amount recommended in the certificate, out of a revolving fund of $300,000,000.

Under Title IV, amendments were made to the Interstate Commerce Act which included § 13, paragraphs 3 and 4, and § 15a. . . . The former for the first time authorizes the Commission to deal directly with intrastate rates where they are unduly discriminating against interstate commerce—a power already indirectly exercised as to persons and localities, with approval of this Court in the *Shreveport* and other cases. The latter, the most novel and most important feature of the act, requires the Commission so to prescribe rates as to enable the carriers as a whole or in groups selected by the Commission, to earn an aggregate annual net railway operating income equal to a fair return on the aggregate value of the railway property used in transportation. For two years, the return is to be 5½ per cent., with ½ per cent. for improvements, and thereafter is to be fixed by the Commission.

The act sought to avoid excessive incomes accruing, under the operation of § 15a, to the carriers better circumstanced by using the excess for loans to the others and for other purposes. The act further put under the control of the Interstate Commerce Commission, 1st, the issuing of future railroad securities by the interstate carriers; 2nd, the regulation of their car supply and distribution and the joint use of terminals; and, 3rd, their construction of new lines, and their abandonment of old lines. The validity of some of these provisions has been questioned. Upon that we express no opinion. We only refer to them to show the scope of the congressional purpose in the act.

It is manifest from this very condensed recital that the act made a new departure. Theretofore the control which Congress through the Interstate Commerce Commission exercised was primarily for the purpose of preventing injustice by unreasonable or discriminatory rates against persons and localities, and the only provisions of the law that inured to the benefit of the carriers were the requirement that the rates should be reasonable in the sense

of furnishing an adequate compensation for the particular service rendered and the abolition of rebates. The new measure imposed an affirmative duty on the Interstate Commerce Commission to fix rates and to take other important steps to maintain an adequate railway service for the people of the United States. This is expressly declared in § 15a to be one of the purposes of the bill.

Intrastate rates and the income from them must play a most important part in maintaining an adequate national railway system. Twenty per cent. of the gross freight receipts of the railroads of the country are from intrastate traffic, and fifty per cent. of the passenger receipts. The ratio of the gross intrastate revenue to the interstate revenue is a little less than one to three. If the rates, on which such receipts are based, are to be fixed at a substantially lower level than in interstate traffic, the share which the intrastate traffic will contribute will be proportionately less. If the railways are to earn a fixed net percentage of income, the lower the intrastate rates, the higher the interstate rates may have to be. The effective operation of the act will reasonably and justly require that intrastate traffic should pay a fair proportionate share of the cost of maintaining an adequate railway system. Section 15a confers no power on the Commission to deal with intrastate rates. What is done under that section is to be done by the Commission "in the exercise of its powers to prescribe just and reasonable rates," *i. e.*, powers derived from previous amendments to the Interstate Commerce Act, which have never been construed or used to embrace the prescribing of intrastate rates. When we turn to paragraph 4, § 13, however, and find the Commission for the first time vested with a direct power to remove "any undue, unreasonable, or unjust discrimination against interstate or foreign commerce," it is impossible to escape the dovetail relation between that provision and the purpose of § 15a. If that purpose is interfered with by a disparity of intrastate rates, the Commission is authorized to end the disparity by directly removing it, because it is plainly an "undue, unreasonable, and unjust discrimination against interstate or foreign commerce," within the ordinary meaning of those words.

Counsel for appellants, not able to satisfy their meaning by the suggestion of any other discrimination to which they apply, are forced to the position that the words are tautological and a mere repetition of "any undue or unreasonable advantage, preference or prejudice as between persons and localities in intrastate com-

merce on the one hand and interstate or foreign commerce on the other hand," which precede them. In view of their apt application to the most important purpose of the legislation, we are not at liberty to take such a view. If "undue, unreasonable and unjust discrimination against interstate or foreign commerce" are tautological, why are they followed by the phrase "which is hereby prohibited and declared to be unlawful"? To accompany a meaningless phrase with words of such special emphasis would be unusual.

It is urged that in previous decisions, notably the *Minnesota Rate Cases*, 230 U. S. 352, the *Shreveport Case, supra*, and the *Illinois Central Case, supra*, the expression "unjust discrimination against interstate commerce" was often used when, as the law then was, it could only mean discrimination as between persons and localities, and therefore that it is to be given the same limited meaning here. But, here, the general words are used after discrimination against persons and localities have been specifically mentioned. The natural inference is that even if they include what has gone before, they mean something more. When we find that they aptly include a kind of discrimination against interstate commerce which the operation of the new act for the first time makes important and which would seriously obstruct its chief purpose, we cannot ignore their necessary effect.

Counsel for appellants are driven by the logic of their position to maintain that the valuation required for the purposes of § 15a to be ascertained pursuant to § 19a of the Interstate Commerce Act (37 Stat. 701; amended 41 Stat. 493), is to be only of that part of the property and equipment of the interstate carriers which is used in commerce among the States and must be segregated from that used in intrastate commerce. This is contrary to the construction which since the enactment of § 19a, March 1, 1913, the Commission has put upon that section in carrying out its injunction. It is inadmissible. The language of § 15a refutes such interpretation. The percentage is to be calculated on "the aggregate value of the railway property of such carriers held for and used in the service of transportation." To impose on the Commission the duty of separating property used in the two services when so much of it is used in both, and to do this in a reasonably short time for practical use, as contemplated by the statute, would be to assign it a well-nigh impossible task. This, of itself, prevents our giving the words such a construction unless they clearly require it. They certainly do not.

It is objected here as it was in the *Shreveport Case* that orders of the Commission which raise the intrastate rates to a level of the interstate structure, violate the specific proviso of the original Interstate Commerce Act repeated in the amending acts, that the Commission is not to regulate traffic wholly within a State. To this, the same answer must be made as was made in the *Shreveport Case* (234 U. S. 342, 358), that such orders as to intrastate traffic are merely incidental to the regulation of interstate commerce and necessary to its efficiency. Effective control of the one must embrace some control over the other in view of the blending of both in actual operation. The same rails and the same cars carry both. The same men conduct them. Commerce is a unit and does not regard state lines, and while, under the Constitution, interstate and intrastate commerce are ordinarily subject to regulation by different sovereignties, yet when they are so mingled together that the supreme authority, the Nation, cannot exercise complete effective control over interstate commerce without incidental regulation of intrastate commerce, such incidental regulation is not an invasion of state authority or a violation of the proviso.

Great stress is put on the legislative history of the Transportation Act to show that the bill was not intended to confer on the Commission power to remove any discrimination against interstate commerce involved in a general disparity between interstate and intrastate rates. Committee reports and explanatory statements of members in charge made in presenting a bill for passage have been held to be a legitimate aid to the interpretation of a statute where its language is doubtful or obscure. . . . But when taking the act as a whole, the effect of the language used is clear to the Court, extraneous aid like this can not control the interpretation. . . . Such aids are only admissible to solve doubt and not to create it. For the reasons given, we have no doubt in this case.

Counsel for the appellants have not contested the constitutional validity of the statute construed as we have construed it, although the counsel for the state commissions whom we permitted to file briefs as *amici cariae* have done so. The principles laid down by this court in the *Minnesota Rate Cases*, 230 U. S. 352, 432, 433, the *Shreveport Case*, 234 U. S. 342, 351, and the *Illinois Central Case*, 245 U. S. 493, 506, which are rate cases, and in the analogous cases of *Baltimore & Ohio R. R. Co.* v. *Interstate Commerce Com-*

mission, 221 U. S. 612, 618; *Southern Ry. Co.* v. *United States*, 222 U. S. 20, 26, 27; *Second Employers' Liability Cases*, 223 U. S. 1, 48, 51, we think, leave no room for discussion on this point. Congress in its control of its interstate commerce system is seeking in the Transportation Act to make the system adequate to the needs of the country by securing for it a reasonable compensatory return for all the work it does. The States are seeking to use that same system for intrastate traffic. That entails large duties and expenditures on the interstate commerce system which may burden it unless compensation is received for the intrastate business reasonably proportionate to that for the interstate business. Congress as the dominant controller of interstate commerce may, therefore, restrain undue limitation of the earning power of the interstate commerce system in doing state work. The affirmative power of Congress in developing interstate commerce agencies is clear. . . . In such development, it can impose any reasonable condition on a State's use of interstate carriers for intrastate commerce, it deems necessary or desirable. This is because of the supremacy of the national power in this field.

In *Minnesota Rate Cases*, 230 U. S. 352, where relevant cases were carefully reviewed, it was said, p. 399: "The authority of Congress extends to every part of interstate commerce, and to every instrumentality or agency by which it is carried on; and the full control by Congress of the subjects committed to its regulation is not to be denied or thwarted by the commingling of interstate and intrastate operations. This is not to say that the Nation may deal with the internal concerns of the State, as such, but that the execution by Congress of its constitutional power to regulate interstate commerce is not limited by the fact that intrastate transactions may have become so interwoven therewith that the effective government of the former incidentally controls the latter. This conclusion necessarily results from the supremacy of the national power within its appointed sphere."

It is said that our conclusion gives the Commission unified control of interstate and intrastate commerce. It is only unified to the extent of maintaining efficient regulation of interstate commerce under the paramount power of Congress. It does not involve general regulation of intrastate commerce. Action of the Interstate Commerce Commission in this regard should be directed to substantial disparity which operates as a real discrimination against, and obstruction to, interstate commerce, and must leave

appropriate discretion to the state authorities to deal with intrastate rates as between themselves on the general level which the Interstate Commerce Commission has found to be fair to interstate commerce.

It may well turn out that the effect of a general order in increasing all rates, like the one at bar, will, in particular localities, reduce income instead of increasing it, by discouraging patronage. Such cases would be within the saving clause of the order herein, and make proper an application to the Interstate Commerce Commission for appropriate exception. So, too, in practice, when the state commissions shall recognize their obligation to maintain a proportionate and equitable share of the income of the carriers from intrastate rates, conference between the Interstate Commerce Commission and the state commissions may dispense with the necessity for any rigid federal order as to the intrastate rates, and leave to the state commissions power to deal with them and increase them or reduce them in their discretion.

The order of the District Court granting the interlocutory injunction is

Affirmed.

APPENDICES

APPENDIX I

PARALLEL READINGS

This appendix contains references to the pages of the present volume arranged in accordance with the chapter outlines of the two books which it is designed to supplement.

1. Railroads: Rates, Service, Management. By Homer B. Vanderblue and Kenneth F. Burgess.

Part I (pages 3–45) of *Railroads: Cases and Selections* presents historical material of an introductory character; it is not otherwise intimately related to individual chapters of the general text; discussion of Part I of this volume may therefore precede discussion of Part I (The Scope and Machinery of Regulation) of *Railroads: Rates, Service, Management.*

Railroads: Rates, Service, Management	*Railroads: Cases and Selections*
Chapters	*Pages*
XII. GROUP RATE PRINCIPLES	(a) 228–240 (Texas Common Points) (b) 240–247 (Percentage System)
XIII. THE SERVICE OBLIGATION	(a) 653–666 (Wilson *v.* New)
XIV. REGULATION OF SAFETY AND HEALTH	(a) 279–281 (Appliances) (b) 281–291 (Train Control) (c) 292–298 (Hours)
XV. TRAINS AND TRAIN MOVEMENT	
XVI. CAR SUPPLY AND CAR DISTRIBUTION	(a) 299–316 (Assigned Cars)
XVII. THROUGH ROUTES AND ROUTING OF FREIGHT	(a) 316–320 (Through Routes) (b) 514–525 (Divisions)
XVIII. TERMINALS AND TERMINAL FACILITIES	(a) 331–340 (Ports) (b) 340–351 (Switching)
XIX. SPECIAL FACILITIES AND PRIVILEGES	
XX. NEW CONSTRUCTION AND ABANDONMENTS	(a) 321–330 (Abandonment) (b) 501–514 (Construction)
XXI. THE FUNCTION OF RAILROAD MANAGEMENT	(a) 399–417 (Scientific Management) (b) 710–720 (Repairs)
XXII. THE REHABILITATION OF RAILROAD CREDIT	(a) 138–146 (Recapture of Earnings) (b) 539–569 (Reorganization) (c) 851–861 (Intrastate Rates)
XXIII. RAILROAD VALUATION	(a) 49–73 (History) (b) 111–138 (I. C. C.)
XXIV. THE PROTECTION OF INVESTORS	(a) 438–451 (Financial Investigation) (b) 452–500 (Security Issues) (c) 525–538 (Leases) (d) 570–574 (Reorganization)
XXV. THE ADJUSTMENT OF LABOR DISPUTES	(a) 667–678 (Wages) (b) 678–702 (Wages) (c) 703–710 (National Agreements) (d) 720–730 (Employee Representation) (e) 730–774 (Strikes) (f) 774–791 (Plumb Plan)
XXVI. THE INTEGRITY OF THE ACCOUNTS	(a) 419–437 (Reports)
XXVII. RAILROAD CONSOLIDATION	(a) 577–602 (Harriman System) (b) 602–621 (Southern Pacific) (c) 622–638 (Ripley Report) (d) 638–650 (General Discussion)

2. Principles of Railway Transportation. By Eliot Jones.

Principles of Railway Transportation Chapters	*Railroads: Cases and Selections* Pages
I. General Introduction	(a) 3–11 (Economic Basis of Transportation Development)
II. Financial Introduction	
III. Historical Introduction	(a) 12–32 (Geographical Distribution of Railroads) (b) 33–45 (Pacific Railroads)
IV. The Theory of Railroad Rates	
V. Ruinous Competition	
VI. Local Discrimination	(a) 163–177 (Competitive Rate Making)
VII. Personal Discrimination	(a) 340–344 (Absorption of Switching Charges) (b) 352–372 (Industrial Railways) (c) 372–379 (Tap Lines)
VIII. The Classification of Freight	(a) 147–156 (Uniform Classification) (b) 156–162 (Classification Principles)
IX. Rate Systems	(a) 178–211 (Equalization Principle) (b) 212–227 (Distance Principle) (c) 228–240 (Texas Common Points) (d) 240–247 (Trunk Line Rate System) (e) 248–259 (Southern Rate System) (f) 259–276 (Transcontinental Rate System)
X. State Regulation	(a) 795–821 (Granger Movement) (b) 822–839 (Federal Regulation of Intrastate Rates) (c) 840–851 (Shreveport Rate Cases) (d) 851–861 (Wisconsin Passenger Fares Case)
XI. The Act to Regulate Commerce of 1887 and Its Interpretation	
XII. The Hepburn Act of 1906	(a) 316–321 (Through Routes) (b) 419–437 (Reports)
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XIV. Miscellaneous Legislation to April, 1917	
XV. Reasonable Rates: Valuation and the Fair Rate of Return	(a) 49–73 (History and Principles) (b) 111–138 (Florida East Coast Case)
XVI. Regulation of Securities	(a) 438–451 (Financial Investigations) (b) 452–460 (General Principles) (c) 460–486 (Stock Dividends) (d) 486–498 (Refunding) (e) 498–500 (Stock Without Par Value)

Principles of Railway Transportation Chapters	*Railroads: Cases and Selections* Pages
XVII. COMBINATION	(a) 577-602 (Union Pacific Combination)
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	(b) 514-525 (Divisions of Joint Rates)
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	(b) 667-702 (Wage Adjustments)
	(c) 703-730 (Rules and Working Conditions)
	(d) 731-774 (Strikes)
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APPENDIX II

TABLE OF CASES

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